

# Income share agreements – what university general counsel ought to know

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Amid widespread concern about student debt and calls for higher education institutions to put more "skin in the game," some have looked to income share agreements (ISAs) as part of the solution. In general, under an ISA, a school or investor provides a student funds for education today in exchange for a percentage of the student's income tomorrow. Incentives are theoretically aligned: the better job a student gets, the more money an institution earns. Like other innovations, however, ISAs largely exist in the interstices of existing legal frameworks and therefore can present challenges.

A June 4 letter from Senator Elizabeth Warren and others [to the U.S. Department of Education \(ED\)](#) and [to seven institutions that have implemented ISAs](#) brings some of those challenges to life. Senator Warren essentially characterizes ISAs as no different than other forms of debt and worries that ISAs "can be predatory and dangerous for students," can result in violations of the Equal Credit Opportunity Act (ECOA), and have received "little federal oversight." She therefore requests ED and the institutions to provide documents and information about ISAs, presumably as an entrée to potential oversight and legislation.

Even so, it's unlikely ISAs are going away. Many coding bootcamps are already using ISAs to fund up to 100 percent of the cost of the program with apparent success. More and more, traditional institutions of higher education are considering adding ISAs as part of the financial aid menu. Companies have emerged and are emerging to help institutions address financing and servicing. Additional regulation is also likely. Below, we describe what ISAs are, identify some of their promises and perils, and outline the legal framework university general counsel should consider.

## What are ISAs?

ISAs trace their roots to the pre-Higher Education Act of 1965 musings of Milton Friedman. Noticing that students need to finance education but lack collateral and credit, he thought a solution could involve trading a student's educational funding for a share in that student's future earnings. In terms of financing instruments, student loans and ISAs may be contrasted accordingly: if student loans are akin to debt-financing where a student borrows a principal amount and is obligated to repay it with interest, ISAs are akin to equity-financing where a student receives funding (or the equivalent) for education with a promise to pay an undefined portion of the student's future earnings (which could be more or less than the initial funding the student receives).

Today, ISAs **can and do take many forms**, including as initial and ultimate funding source, key payment terms, and caps. For example, some institutions have raised money from donors to create a revolving institutionally managed fund to start an ISA program. Other ISAs involve private investors funding individual students or purchasing ISAs from institutions. ISAs also differ as to when a student's obligation to begin repayment kicks in (for example, after a set period of time or after exceeding a salary threshold); what counts as income (for example, a line from a student's tax return); and how much students must repay (for example, capped at the initial amount of funding received or some other amount or for a certain period of time). ISAs therefore differ in the extent to which they resemble a traditional private education loan, which has regulatory implications that we address below in the section, "What are some of the key legal issues when constructing an ISA program?"

So far, most traditional Title IV-eligible higher education institutions have viewed ISAs as a potential alternative for private education loans or some high-cost federal Parent Loans for Undergraduate Students (PLUS loans), not as a general replacement for Title IV. However, that could change to some degree with interest rates and the regulatory environment. And some programs already permit students to use ISAs to finance practically the entire cost of the program.

### **What are some potential advantages and challenges?**

ISAs have the potential to benefit both institutions and students. Many students seek higher education to improve their careers. In theory, the better an institution's education program prepares a student to succeed, the better an institution's chances of recovering the ISA investment in the student. ISAs are a potentially powerful way for institutions to testify to the quality of their education programs (because the institutions take the downside risk and may need to cap the upside for legal and practical reasons). Students receive the certainty that any payment due will be tied, not purely to the program cost, but to what the students earn.

Yet there are also challenges. For an institution-based ISA program, one challenge is funding: an institution must find ways to bridge the gap between when a student enters into an ISA and when the student begins repayment. Another is defining and confirming a student's income and collecting the required payments. There are also practical problems around adverse selection, modeling whether an ISA program will at least break even, and addressing concerns about how ISAs compare to student loans (including whether students will pay more or less under various alternatives).

Another big challenge is overall lack of legal clarity. For example, Senator Warren's letter seems to characterize ISAs as just another form of consumer credit, but it is far from clear that is correct as a legal matter. True consumer credit transactions are often distinguished by features that are unlike ISAs. For example, ISAs do not typically impose an absolute obligation for students to repay because they generally only pay if their income meets a certain threshold or a percentage for a certain number of years. Other factors may also contribute to the analysis, such as whether the funder maintains a right of recourse under the ISA agreement. Universities are grappling with these legal uncertainties in an effort to provide solutions for their students; Purdue University's President Mitchell Daniels **testified** before Congress in 2015 that "widespread use of income-share agreements is not realistic without legal clarity and adjustments to the regulation of student data."

### **What are some of the key legal issues when constructing an ISA program?**

As institutions construct ISA programs, they need to address a range of potential legal regimes related to general consumer finance and education regulatory requirements. We provide a high-

level outline of some of them below. However the puzzle pieces fit together, it is important under unfair and deceptive trade practices law to give students a clear understanding of what the ISA is, how it works, and how it compares to other financing alternatives. Institutions should similarly seek to provide students with information about regulatory rules that may affect students more than institutions (such as income tax and bankruptcy implications).

#### **Select federal consumer financial laws**

Existing federal consumer financial statutes and regulations governing consumer credit do not expressly address ISAs. However, as Senator Warren's letters evidence, ISAs may look like consumer credit to varying degrees. It is therefore important to analyze the extent to which a particular ISA triggers existing federal consumer financial laws. Even where such laws may not technically apply, referring to the laws while constructing an ISA program may help entities understand and reduce regulatory exposure arising from the agreements.

Because ISA agreements can – even inadvertently – be structured in a way that resembles traditional consumer credit transactions (i.e., loans), they may implicate the federal Truth in Lending Act (TILA) and other federal consumer financial laws applicable to consumer credit. TILA generally applies to extensions of "credit," which it defines broadly as the "right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." The term "debt" is not expressly defined in TILA, which often leaves the interpretation of its applicability to the courts. The extent to which ISAs may qualify as debt under TILA will often depend on the terms of repayment and whether students have a definite obligation to repay the initial funding amount. To the extent TILA applies, it imposes certain disclosure and timing requirements, including special rules for private education loans.

In addition to TILA, ISAs may implicate other federal consumer financial laws. The analysis for how ISAs would be covered under each depends on the associated scope, definitions, and interpretations. Senator Warren's letter raised questions regarding ECOA, for example, which prohibits creditors from discriminating against applicants with respect to certain protected categories, including race and sex. Senator Warren worried that there could be discrimination where ISA terms are tailored based on a student's characteristics or program (particularly where enrollment in certain programs is highly correlated to gender or race). ECOA's definition of credit, however, is slightly different than TILA's which raises additional legal considerations about how to structure and characterize ISAs.

There are a host of additional laws that cover consumer financial services, including the Fair Credit Reporting Act (which regulates access to and use of credit reports and consumer credit information); the Gramm-Leach-Bliley Act (which imposes certain consumer privacy and information security requirements on covered institutions); the federal Prohibition against Unfair, Deceptive, or Abusive Acts or Practices; and the Electronic Funds Transfer Act (which imposes restrictions and obligations when debiting a consumer bank account); among others.

#### **Select federal education regulatory requirements**

Institutions participating in Title IV also need to consider how ISAs may affect Title IV compliance. For example, depending on the funding source and extent to which ISAs are structured to resemble traditional private education loans, they may implicate the complex regulations that apply to preferred lender arrangements and preferred lender lists. Regardless, ISAs can affect students' Title IV award packaging, including, for example, whether ISAs would qualify as estimated financial assistance that must be factored into a student's need calculation. It is also important to comply with general Title IV requirements related to consumer information and misrepresentation.

In addition, particularly where there are third-party servicers involved, it will be important to consider and comply with the Family Educational Rights and Privacy Act.

### Various state laws

Because ISAs are contracts, an analysis of state contract law is necessary. There are also general state consumer protection and consumer financial laws. Among those are state interest rate limitations and usury statutes, as well as licensing laws applicable to consumer lending activities (e.g., generally, lending, servicing, collecting, and brokering) and laws that govern such activities. Needless to say, it is prudent to consider how to structure the ISAs and how to cap students' ISA repayment obligations to best navigate potential issues and claims under these regimes.

In addition, some states have sought to adopt ISA-specific legislation. For example, the Illinois legislature [just passed a bill](#) that would recognize ISA agreements under state law and permit the state treasurer to enter into ISA agreements and facilitate ISAs between participants and ISA providers. There are bills now pending in [California](#) and [Washington](#) to create pilot ISA programs. Each of these bills describes required ISA contract terms and disclosures, which may help to provide a road map for institutions seeking to establish an ISA program. Other states have recently [considered bills related to ISAs as well](#).

Even where there is not legislation that explicitly addresses ISAs, some education regulatory state authorizing agencies have taken a position on ISAs. Just this month, the New York Bureau of Proprietary School Supervision (BPSS), [updated](#) a policy that use of an ISA "requires prior approval by BPSS." BPSS is also "currently revising its policy guidance regarding . . . ISAs." The California Bureau for Private Postsecondary Education (BPPE) has held a number of proceedings on ISAs and given consideration regarding whether and how they implicate the laws BPPE enforces.

### Accreditation

ISAs may implicate accreditation standards related to compliance with law and consumer protection.

### What will the future bring?

The future will probably bring more regulation. In 2017 Senators Rubio and Hill introduced the "[Investing in Student Success Act of 2017](#)," which was designed to preempt state law as to the lawfulness of ISAs and to provide a clear legal framework for their implementation. In general, the bill defined income, income thresholds for when a student would be obligated to make payments, aggregate limits on the amount a student could be required to repay, required disclosures, and early opt-outs. Senator Warren's recent letters in response to a potential ED pilot program and institutions that have begun to offer ISAs suggest that Congress and/or ED may soon (re)enter the fray. As indicated above, state legislatures and agencies are also considering proposals. All of this suggests that lawmakers and regulators at the federal and state level are interested in and may take action on ISAs, and the ground may shift over time.

In sum, ISAs are a potentially promising tool for financing a higher education. To realize the benefits, institutions need to navigate successfully the corner of general consumer protection and finance law and education regulatory requirements.

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