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Perspective
EXPERT INSIGHTS ON A TIMELY POLICY ISSUE

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Are Income Share Agreements Fair?

A Close Look at the Potential Risks and Benefits of an Emerging Financial Aid Option

For some Americans, education after high school—that is, postsecondary education—is a way to move out of poverty and into the middle class. By most accounts, workers who complete certificate programs or two- or four-year college degrees earn higher wages and are less likely to be unemployed than those with a high school diploma or less.[1] The United States is beginning to emerge from the COVID-19 pandemic and related recession, and those whose careers have been interrupted by the pandemic may find that employment-relevant education is more important than ever.[2] Others who have been looking or stopped looking for work may decide that the time is right to obtain postsecondary credentials to help them secure better jobs once they are ready to return to the workforce. Further, manufacturing and other sectors are increasing their use of automation, which demands the digital and technical fluency that can be obtained through postsecondary education.

However, pursuing postsecondary education and training is expensive. This puts many low-income people into what seems like an impossible sit-

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uation: If you need money to enter programs that will eventually help you earn money, how and where do you start? According to a recent national survey, almost 25 percent of Americans planned to enroll in postsecondary education in the next six months but felt that cost was a major barrier.[3] These perceptions are not unfounded; the cost of pursuing postsecondary education is rising, and students are paying a larger share than ever before.[4] While traditional grants, loans, and other kinds of postsecondary financial aid are usually available, these can be difficult to access, and their amounts have not kept up with rising tuition. Attending school also reduces the amount of time in which one can work, resulting in loss of earnings, which puts less-resourced students under even greater financial pressure. Financial barriers to postsecondary education limit mobility into and stability within the American middle class.

In response, an increasing number of postsecondary schools and education programs have started offering a different kind of aid option. *Income share agreements,* or ISAs, are contracts between students and funders in which the student borrows money to fund their postsecondary education and pays back a percentage of their salary (e.g., 5 percent) when they have a job that allows them to make such payments. Once only a rare option for students in some private vocational programs, ISA implementation is growing. More and more four-year colleges and universities, certificate programs, and career skill bootcamps are setting up ISA programs, and several historically Black colleges and universities have recently adopted them.[5] So far, educational institutions generally offer ISAs to students in programs from which most graduates are expected to achieve high earnings, thus increasing the chance that the student will meet their repayment obligations. Such programs include science, technology, engineering, or mathematics (STEM) degrees, as well as coding certificates and noncredential programs. Student eligibility for an ISA varies by institution. Some institutions offer ISAs only to students in STEM programs; others offer them only to students who meet set thresholds of financial need. Some ISA-offering programs have explicit goals to recruit students from disadvantaged backgrounds.

ISAs can have implications both for individual students and for the institutions that offer ISAs. Both dimensions are important, but the focus of this Perspective is on the implications for students. ISAs have clear benefits for students. They are designed to promote greater access to postsecondary education for students who might otherwise have trouble paying for school. Further, they offer protection for students who would have difficulty paying off traditional loans, such as those who do not complete the program or who cannot find employment after graduation. However, as with any financial contract, ISAs carry risks

for the students signing them. Equitable implementation is key; in its absence, ISAs could uniquely harm already-disadvantaged students.

In the sections that follow, we describe ISAs in detail and compare them with other common types of financial aid. We then describe some of the benefits and risks for students in the context of the current absence of regulation for ISAs. This information can help postsecondary financial aid administrators think about how to communicate and structure ISAs to maximize student supports and minimize the chance of inequitable treatment. It can also help policymakers think about how to craft a regulatory structure for ISAs that supports those same goals.

How Do ISAs Compare with Other Types of Financial Aid?

Students seeking financial aid for postsecondary education generally have three options:

- **federal student grants.** This type of aid includes the Pell Grant and is available to students who meet set criteria for financial need, individual eligibility, and program eligibility.
- **federal loans**. This type of support is available to U.S. citizens and permanent residents enrolled in approved credential-granting programs and includes both subsidized and unsubsidized loans.
- **private student loans.** These are available to creditworthy students (or students with creditworthy cosigners) enrolled in approved credential-granting programs.

Federal grants do not need to be repaid and are generally a student's first stop for financing postsecondary education. After exhausting this resource, students typically turn to subsidized federal student loans and then unsubsidized federal and private student loans if need remains. ISAs could also fill in this gap, but the comparative advantage of ISAs depends on a student's individual circumstance.

Federal and private loans are obligations typically repaid on a monthly basis. Federal loans come with low interest rates set by the federal government that currently range from 2.75 percent (subsidized) for undergraduate students to 5.30 percent for parents of students. Students are allowed to repay these loans in two ways. They can choose to pay on a standard, mortgage-style repayment plan, which includes a fixed interest rate and repayment term (e.g., ten years) with predictable incremental (e.g., monthly) payments and a fixed total repayment amount. Students may alternatively choose income-based repayment, in which the incremental payment varies based on income, but the total repayment amount is still fixed. (Private loans are repaid on a mortgage-style plan; income-based repayment is generally not available.) About one-third of federal student borrowers are enrolled in income-based repayment plans.[6] Private loans carry interest rates set by the lender and currently range from 4 percent to 13 percent. Most lenders allow students to defer payments on the loan principal for the first six months after graduation. Under such an arrangement, students have no repayment obligation but can get a head start on repayment by making interest-only payments while they seek work that will allow them to pay down the loan's principal and accrued interest.

In contrast, ISAs offer an income-based repayment plan in which both incremental (e.g., monthly) payments and the total repayment amount are *conditional on income*. The funder, typically the postsecondary institution, covers the student's educational expenses up front in return for a percentage of the student's income after program completion (see Box 1). Although there is no explicit repayment amount guaranteed to the funder in the ISA contract, ISA sustainability requires that, on average, repayments cover ISA cost (including the cost of forgone investment opportunities).

ISAs have some advantages over traditional mortgage-style and income-based repayment plans. As described in Table 1, ISA payments begin only when the student's income rises above a certain threshold (known as the *income base*). The income base is set at a level meant to support basic cost of living. ISA payments pause if the student's income falls below the income base. In contrast, under mortgage-style and traditional income-based repayment plans, students must pay regardless of income, and it is not possible to pause payments.

But the ISA's protections against times of lower post-program income come with some disadvantages relative to traditional payment options. Under an ISA, the total amount that a student who exits or completes the pro-

Box 1. Common ISA Terms

Income base—the minimum income at which payments are required

Income percentage—the fraction of income promised if income exceeds the income base, e.g., 8 percent

Repayment term—length of repayment period (some situations may pause or restart the payment clock), e.g., ten years

Repayment cap—maximum amount a student would have to repay

TABLE 1
ISAs Differ from Traditional Repayment Plans

Repayment Plan	Repayment Amount	Incremental Payment	When Do Payments Begin?	When Do Payments End?	Protections for Times of Lower Post-Program Income
Mortgage-style	Fixed	Fixed	6 months after graduation[a]	When the amount of the loan is repaid	No, same payment due
Income-based repayment	Fixed	Conditional on income	6 months after graduation[a]	When the amount of the loan is repaid	Yes. Payment is reduced if income is reduced.
ISA	Conditional on income	Conditional on income	When income rises above a certain threshold (income base), at least 6 months after graduation	When either the repayment cap or repayment term is reached	Yes. No payment if income falls below the income base[b]

[a] During the coronavirus disease 2019 (COVID-19) pandemic, payments on the principal of federal student loans have been paused, but interest continues to accrue.
[b] Whenever income exceeds the income base, ISA payments are a fixed percentage of income: payment amount increases as income increases.

Box 2. ISAs Protect Students with Low Post-Program Incomes

Unlike traditional loans, the structure of an ISA protects all students who have low incomes after leaving their education programs. These might include

- **students who complete their programs** but afterward are either unemployed or earning a low income
- **students who do not complete their programs (drop out or temporarily withdraw)** and may not have the same potential to earn high wages as program completers.

gram (see Box 2) will end up repaying is conditional on their income, on the *income percentage* (the percentage of a student's income promised in a given payment), and the length of the *repayment term* specified in the ISA contract. Thus, ISA students who earn high incomes may end up paying more than they would under a standard loan. However, a maximum repayment amount (e.g., 200 percent of the funded amount) is often defined in the ISA contract (this is known as a *repayment cap*) to limit excessive overpayment. Moreover, ISAs are new and, like traditional loans, can be difficult for potential students to understand.

ISA enforcement terms may also be difficult for students to understand. Because payments are based on earnings, ISA recipients are generally required to verify their earnings via pay stubs or tax returns and reconcile payments annually. Students can be subject to consequences in the event of nonpayment. Most ISAs contain provisions that permit ISA funders to report nonpayment to credit bureaus.

The variation in ISA terms persists in part because ISAs are not regulated by the federal government. That is, there are no requirements for the structure of the contract or how the terms are defined. Thus far, ISA contracts appear to have a common structure and generally specify an income base, income percentage, repayment term, and repayment cap (defined in Box 1). Some ISAs include features to support program completion and employment, such as a stipend to cover costs of living, child care, tutoring, or assistance with interviewing techniques and résumé writing. The lack of regulation means that we do not know exactly how many programs offer ISAs, the characteristics of those programs, how common ISA terms are defined (e.g., the most common income percentage or income base), or which include supports for program completion and employment.

ISAs Could Benefit Students with Low Incomes

ISAs can increase the accessibility of postsecondary education and training as a pathway to middle-class jobs. ISAs give students without substantial resources more financial access to postsecondary education—particularly STEM education. ISA repayment terms present less risk than a loan would to the student and, thus, could encourage more students—particularly those who are deterred by the potential burden of student loan debt—to pursue postsecondary education. ISA repayment terms, which are conditional on employment, could incentivize students to pursue higher-earning fields (e.g., STEM fields). By extension, if ISAs induce more students from underrepresented backgrounds to pursue postsecondary education, ISAs

ISAs effectively lower the penalties of noncompletion because payments are conditional on income.

could also increase the representation of such students in STEM programs.

ISAs incentivize programs to support their students throughout their educational and working careers. ISAs have the potential to help students persist in postsecondary education, progress in their fields of study, and complete their degrees or programs. Because repayment is conditional on earning a certain income, and students who earn more repay more, ISA-offering programs have an incentive to provide supports (e.g., stipends, child care, tutoring) to help students complete their degrees in their fields of study, thus increasing the likelihood that the student obtains more-gainful employment. Some ISA programs also provide supports (e.g., connections to employers, child care for interviews) to help students find and maintain employment.

Additionally, for students who must drop out or stop out despite these supports, ISAs effectively lower the penalties of noncompletion because payments are conditional on income. Repaying traditional student loans can be challenging for students who do not complete their programs because monthly payment amounts are fixed even in the case of lower incomes. That is, the student needs to repay the amount borrowed even if the partial postsecondary education did not give them remunerative skills. In the case of an ISA, the minimum income threshold and scaled payments apply regardless of program completion or credential attainment. An ISA student who stops out or drops out and earns low wages is protected by the minimum income threshold (repaying nothing), and when income rises above that threshold, their payments are proportional to their income, increasing the likelihood that the payments are affordable. An ISA student who earns high wages, regardless of program completion, will also have proportional payments that scale with their income.

ISAs can empower students to choose the jobs that are their best long-term fit. Although ISA-offering programs are incentivized to support their graduates in securing high earnings, such earnings are less critical from the student's perspective because of the flexible repayment structure. Flexible repayment could also improve the quality of match between ISA graduates and their jobs and, thus, facilitate longer-term employment because graduates are more able to choose jobs with workplace cultures and benefits more aligned to their needs. Moreover, the fact that repayment capability is not contingent on earning a high income may also support students who are called to less remunerative career paths—e.g., ISA-funded law school graduates may be more likely to take jobs in legal aid offices or firms with substantial pro bono commitments. In sum, ISAs could increase the likelihood that a student completes their education or training in a job-aligned program *and* that the student obtains long-term, gainful employment in their field.

ISAs Could Uniquely Harm Already-Disadvantaged Students

ISAs are new, and the structure and terms are both unfamiliar and substantially different from the more common mortgage-style and income-based repayment plans. Understanding the risks and benefits of an unfamiliar financial product—such as an ISA—requires substantial financial literacy or access to financial literacy resources. Students who do not understand what they are signing up for—perhaps because they have not taken a personal finance course or do not have family members who are knowledgeable about financial investments[7]—when they choose an ISA could make unfavorable financial or education decisions. Although some programs that offer ISAs provide individual financial counseling about the merits of ISA funding, these supports are not universal. High school counselors and parents may be similarly unequipped to help students evaluate the risks and benefits of an ISA. Here are several to be aware of:

ISAs are not yet regulated. The lack of regulation means that there are no protections in place to prevent predatory ISAs. For example, the absence of rules about what constitutes a reasonable income base, income percentage, or repayment cap could result in students paying much more than the cost of their education (relative to a loan) or being forced to begin repayment when they are not yet earning a livable wage. In addition, ISAs are more attractive to students when post-program incomes are low. Because the disclosures presented to students are unregulated, ISA programs are able to selectively report graduates' expected incomes in a way that emphasizes lower student incomes (and thus the comparative attractiveness of ISA repayment) to encourage participation.

ISAs could be a new mechanism for discrimination in the absence of regulation. The actuarial process that determines ISA terms could introduce discrimination at the individual and institutional levels. ISAs differ from traditional financing methods in that payment amounts are not fixed, but the ISA funder still needs to be paid back. Because the earnings of students vary, the percentage of income needed to reach a targeted level of repayment will also differ. If ISA terms were priced at the individual level, ISA students with indicators of high potential earnings, such as exceptional SAT scores, would be given more advantageous repayment terms. Although this approach could benefit high-achieving students from disadvantaged backgrounds, it is also likely to offer unfavorable terms to high-potential students who don't have the support they need to achieve high scores on traditional measures of achievement.

Algorithms can introduce bias even when ISAs are priced at the program level. To approximate those expected repayments and determine the income percentage, ISA-pricing agencies take what seems to be a reasonable approach: They use algorithms to predict the student's future earnings (unknown at the time) based on the earnings of previous graduates in their program.

But employment rates and earnings—key inputs to pricing an ISA at the institutional level—vary based on immutable demographic characteristics (e.g., race, ethnicity, and gender) because of discrimination in the labor market.[8] Moreover, these characteristics can be correlated with choice of program, major, or institution. Because the inputs to ISA pricing algorithms rely on outcomes realized in a labor market in which discrimination is present, the standard process for pricing an ISA can result in unintended

"algorithmic" bias, putting some students at a disadvantage according to their personal characteristics.

For example, students graduating from Smith College (which admits only women) with a degree in psychology earn an average of $22,937, whereas students graduating from Wake Forest University (which has a similar level of application selectivity) with the same degree earn an average of $29,685.[9] Their tuitions are similar, so a "fair" ISA would require a higher percentage of the Smith College graduate's income to recover a similar repayment. These factors could result in similar students receiving vastly different ISA terms because of their gender, race, or ethnicity, thus institutionalizing labor market discrimination at the cost of education. A recent "secret shopper" review of terms at one ISA provider found that students at historically Black colleges and universities were offered less-favorable terms than equivalent students in the same major at other colleges and universities.[10]

Increasing financial access to less-regulated education programs can harm students in the long run. ISAs have been lauded for their ability to expand financial access to students and programs that are not eligible for federal student loans—for example, such shorter-term programs as bootcamps. Some of these programs play a key role in qualifying their students for emerging *new collar* jobs (jobs that pay good wages and require some postsecondary training but do not require a four-year college degree). However, expanding access to less-regulated programs can have concrete harms for students, especially if that access is concentrated on a vulnerable population. For example, until recently, GI Bill benefits encouraged for-profit schools to recruit military veterans as students.[11] ISAs often have enrollment goals targeting students of color or students from low-income families, making careful monitoring of student outcomes critically important.

Conclusion

ISAs have great potential as a means of financing postsecondary education and broadening access to economic opportunity, particularly for students from low-income backgrounds and students of color. But the devil—and the key to equitable implementation—is in the details. On the one hand, ISAs offer protections for students with low post-program incomes and provide an economic incentive for educational institutions to supply supports, such as tutoring, child care, living stipend, or résumé review, to ensure that students complete the program and secure high-paying, long-term employment. On the other hand, the absence of regulation—and concurrent absence of standardized approaches for determining eligibility and setting ISA terms—could allow ISAs to become a mechanism for discrimination, compounding existing inequity in financing postsecondary education and training.[12]

The upsides of ISAs are concrete. They have the potential to increase access to postsecondary education, particularly for students with low incomes, because they protect against overly burdensome repayment for students who do not get high-paying jobs. But ISAs have many potential drawbacks for low-income students, and many of the implications of ISAs at scale are not well understood. The current landscape—with limited regulation, insufficient information on ISAs, and potential for discrimination—may elevate the risk that ISAs could disadvantage, rather than support, vulnerable student populations. Further, we do not yet understand how ISAs may (or may not) affect students' short- and long-term financial, education, and labor market decisions. In an economic climate in which more people may be considering changing careers or returning to school despite strained finances, ISAs could proliferate. It is critical

that we identify best practices and resources to enable equitable and fair implementation of ISAs. Such best practices could include resources and supports for students, families, and counselors to understand ISAs and make advantageous financial decisions, or the optimal mix of wraparound services that ISA-offering institutions should provide.

Notes

1 Ma, Pender, and Welch, 2020.

2 Strada Education Network, 2020a.

3 Strada Education Network, 2020b.

4 Laderman and Weeden, 2019; Ma, Pender, and Welch, 2020.

5 Business Wire, 2020.

6 U.S. Department of Education, undated-b.

7 Jacobsen and Correia, 2019.

8 Leonhardt, 2020; Blau and Kahn, 2017.

9 U.S. Department of Education, undated-a.

10 Student Borrower Protection Center, 2021.

11 Craven, 2020.

12 Brown, 2021.

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About This Perspective

In this Perspective, the authors examine the income share agreement (ISA), a novel mechanism for students to finance postsecondary education through which students can obtain funding for school in exchange for a share of their future income. Benefits include increased access to postsecondary education, increased support for completion of job-aligned programs, and a reduction of risk for those who do not obtain well-paying jobs after completing or dropping out of their programs. However, ISAs pose unique risks stemming from their lack of regulation and standardization. Programs may be incentivized to misrepresent students' expected earnings; outcomes-based pricing may lead to inequitable contract terms by student race, ethnicity, or gender; and less-reputable programs may use ISAs to profit from misinformation. This Perspective will be of interest to students considering ISA financing, program administrators debating how to implement their ISAs, and policymakers seeking to establish a regulatory framework for ISAs.

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RAND Lowy Family Middle-Class Pathways Center

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For more information about the RAND Lowy Family Middle-Class Pathways Center, visit www.rand.org/mcpc. For more information on RAND Education and Labor, visit www.rand.org/education-and-labor.

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