



Income-Share Agreements Burden Students with Unfair Terms and Unforeseen Costs

March 2022

“Income-share agreements,” or ISAs, fund a portion of educational costs in exchange for a percentage of a student’s earnings over time. Many ISA providers continue to argue that their products are not loans even though they lend money and subsequently require repayment, employing an old and predatory tactic that loan providers use to evade consumer protection guardrails.¹ In fact, ISAs are simply high-cost loans that currently lack even the protections afforded to private student loans, which themselves are a worse option than federal student loans for most borrowers.

The high cost of ISAs often results in unmanageable repayment burdens, and discriminatory impacts on women and people of color. States can and should reject attempts by ISA providers to market their product as an “innovation,” and policymakers must regulate ISAs as loans and provide the same protections to borrowers as those who use federal and private loans to finance their education.

Despite industry marketing of ISAs as “innovative” products, ISAs are dangerous private loans that allow private investors to put a super lien on a borrower’s future income without guardrails against unfair practices. Even worse, ISAs do nothing to address the root causes of the student loan crisis – the unaffordable cost of a college education and the failure of a myriad of repayment options to adequately address those costs.

Throughout the pandemic, ISA programs have been created and advertised around the nation,² leading some advocates to warn that companies promoting ISAs see the COVID-19 crisis as “an opportunity to capitalize on borrowers’ vulnerability and make a quick buck.”³ These products are, unfortunately, a new attempt by lenders to profit from the student debt crisis and the associated problems with the high cost of higher education. Addressing the student debt crisis requires cross-the-board debt forgiveness and better federal repayment and discharge options, not new types of debt.⁴

While ISAs are relatively new products, emerging trends are concerning. This memo provides a regulatory overview and highlights four potential risks presented by income-share agreements to borrowers:

- the high-cost relative to other student loan options;
- the risk of unmanageable repayment situations for borrowers who “stack” ISAs on top of federal student loans;
- the risk of lending discrimination; and

- a lack of critical consumer protections.

ISAs are Private Student Loans: A Regulatory Update

The regulatory landscape related to income-share agreements is rapidly evolving. During the Trump Administration, several proposals sought to exempt ISAs from a wide range of usury and wage assignment laws, including allowing special treatment under the US Bankruptcy Code.⁵ ISA companies have long asserted that federal consumer protection laws, such as Equal Credit Opportunity Act (ECOA), the Truth in Lending Act (TILA),⁶ and state usury caps should not, or do not, apply to ISA loans.⁷

More recently, however, some state and federal regulators have indicated that ISAs are private student loans and should be treated as such under the law. These actions are positive, but limited, and federal regulation is needed to ensure that all ISA providers are subject to TILA and other consumer protection laws:

In August 2021, the California Department of Financial Protection and Innovation (DFPI) entered an agreement with an ISA servicer to regulate ISAs as a student loan servicer under the California Student Loan Servicing Act. The agreement subjects ISA providers to the same responsibilities to consumers as other student loan servicers. DFPI's regulatory authority includes regular examinations to ensure that consumers are being treated fairly and receiving honest information from their servicers.

In September 2021, an enforcement action from the Consumer Financial Protection Bureau (CFPB) found that ISA provider Better Future Forward misled students by telling them their product was not a loan and did not create debt. Under the consent order, the provider agreed to stop saying their ISAs are not loans and to provide disclosures provided by laws such as TILA, to allow consumers to evaluate and compare lending products. Through this order, the CFPB made it clear that ISAs are private student loans and should be regulated as such.

The regulatory status of income-share agreements is still unclear in many jurisdictions, with ISA companies and their lobbyists working hard to convince state governments to pass loophole bills that allow them to circumvent even the paltry existing protections given to student loan borrowers.

Drawbacks of Income-Share Agreements

As the legislative and regulatory history reveals, income-share agreements are being offered at many institutions around the country with differing terms. ISAs have several problematic drawbacks:

- ISAs are expensive.** ISAs often end up costing much more than federal loans over the life of the loan because of unfavorable terms and a lack of consumer protections for ISA borrowers.⁸ In the worst cases, ISAs can cost borrowers up to 40% of their pre-tax income and can trap borrowers in repayment even through economic crises.⁹ These practices pale in comparison to even the flawed federal repayment plans, which have given borrowers a temporary pause on payments during the COVID-19 pandemic, offered payments adjusted to borrower income, and provided a wide variety of discharge options for borrowers whose schools have closed, who are totally and permanently disabled, or who have been paying on their loans for decades.¹⁰ These benefits are typically not available to borrowers of private student loans and ISAs, and, indeed, some borrowers with ISAs have actively been pursued by debt collectors during the pandemic.
- The practice of “stacking” loans results in unmanageable repayment burdens.** Because ISAs often supplement federal or private loans, borrowers may “stack” debt, or use multiple sources of debt at the same time, which can lead to a higher debt burden for low-income borrowers and their families and unaffordable obligations during repayment (Figure 2).

Figure 2: Borrowers Using Both Federal and ISA Loans Could Pay as Much as 25% of Discretionary Income in Repayment for a Decade

Year	Annual Salary	Annual Discretionary Income Amount	Annual ISA Payment	Annual Federal Student Loan Payment	Combined Annual Loan Payments as a Percent of Discretionary Income
2023	\$35,000	\$14,899	\$2,590	\$1,490	27.4%
2024	\$36,400	\$15,897	\$2,694	\$1,590	26.9%
2025	\$37,856	\$16,943	\$2,801	\$1,694	26.5%
2026	\$39,370	\$18,039	\$2,913	\$1,804	26.2%
2027	\$40,945	\$19,188	\$3,030	\$1,919	25.8%
2028	\$42,583	\$20,390	\$3,151	\$2,039	25.5%
2029	\$44,286	\$21,650	\$3,277	\$2,165	25.1%
2030	\$46,058	\$22,968	\$3,408	\$2,297	24.8%
2031	\$47,900	\$24,349	\$3,545	\$2,435	24.6%
2032	\$49,816	\$25,794	\$3,686	\$2,579	24.3%

Note: This example models repayment for a borrower graduating in December 2023 who has stacked an \$18,500 ISA advance on top of \$31,000 in federal student loans. The model assumes that the borrower is enrolled in an income-driven repayment (IDR) plan for the federal loans and is treated as a single adult household and assumes that ISA repayment begins July 2024 and ends after 112 monthly payments.¹¹

- High risk of lending discrimination:** ISA underwriters attempt to predict the future financial value of the borrower to determine the terms of their loan. ISA agreements could result in violations of the Equal Credit Opportunity Act (ECOA) if the attempt to predict

future income results in protected classes of borrowers receiving unfavorable repayment terms or different pricing, which could occur if loan terms are determined by majors or schools.¹² College majors are already highly stratified by race and gender and using them as underwriting criteria could lead to disparate impact.¹³ For instance, ISA terms relying on a course of study could potentially result in higher rates for elementary education majors, a field in which women are overrepresented. Because of these types of underwriting strategies, ISA issuers sometimes refuse to treat lower-income workers and students of color fairly while conferring advantages on those who need the least help.¹⁴

Unfortunately, these underwriting strategies can also lead to unfair pricing for students at institutions that serve more students of color. Research has shown that private loan companies have charged more to students from historically black colleges and universities (HBCUs) with the same salary and course of study than to students from comparable, local predominantly white schools.¹⁵ Similarly, borrowers at community colleges, which enroll higher shares of students of color,¹⁶ may be charged higher rates than similarly situated borrowers from other institutions. There is already evidence that these issues are present in the private student loan market. A private loan pricing study at Wells Fargo found that a community college graduate was charged a higher interest rate than a student with the same major, occupation, and income who attended a four-year college.¹⁷

- 4. ISAs are not always regulated as private education loans and, thus, lack critical disclosures and protections.** Even after the guidance from the CFPB in September 2021, some ISA providers continue to argue that their products are not loans even though they lend money and subsequently require repayment. Because of this, some ISA programs operate without adhering to the consumer protections that protect private student loan borrowers.

When a provider offers a loan, they must follow standardized disclosure requirements and adhere to other consumer protection regulations. Thus, the true costs of ISAs are difficult to ascertain when providers refuse to define their products as loans or provide required TILA disclosures. Disclosures are especially important for students to compare financing options in the context of ISAs, where structure and terms vary across institutions. For example, for-profit and vocational programs generally require a larger income share over a shorter term, while traditional colleges tend to require a smaller income share over a longer term. And under typical ISA agreements, it is often unclear to the borrower how affordable monthly payments will be or how defaults will be handled.

The ISA marketplace also lacks key controls over prepayment penalties, pricing comparisons and calculations, income verification, and affordability due to a lack of regulation. Supporters argue that ISAs, which typically require repayment over a fixed term (usually ranging from two to 10 years) or payment until a maximum cap is reached (typically

ranging from 1 to 3 times the original amount) are more affordable than traditional loans. However, they fail to note that the payment cap acts as both a ceiling and a floor. A student wanting to pay the loan off early must pay no less than the payment cap, in what essentially amounts to a prepayment penalty, which is prohibited under TILA for private education loans.¹⁸

Finally, by signing ISA contracts, borrowers often waive their rights to jury trials and class actions. Instead, they must resolve disputes through binding arbitration, a method that typically favors the ISA provider over the borrower. Some ISAs even have borrowers sign off on extreme collection tactics including seizure of state tax refunds, access to borrowers' bank accounts, and other punitive terms in their loan agreements.^{19,20} In these ways, ISAs are not just designed to avoid recognition as private loans but, in fact, are structured to evade specific restrictions that apply to private education loans.

ISAs Are Not a Solution to the Student Debt Crisis

Income-share agreements are a high-cost, risky alternative to federal student loans and are simply a new type of private student debt. Creating new types of high-cost debt and exempting that debt from even the modest protections afforded to private student loans will not resolve the crisis of unaffordable higher education. Policymakers should be skeptical of ISAs, as well as the high cost and lack of consumer protections that come with them. Indeed, most borrowers recognize that the risks of ISAs outweigh the possible benefits: When presented with two statements, three in five (61%) student loan borrowers in North Carolina agree that the lack of consumer protections and risk of "stacking" outweigh the purported benefits of ISAs.²¹

Congress should not take any steps to exempt ISAs from important protections available to other forms of student debt, and regulators must prohibit further expansion of ISAs as they exist today and classify existing ISAs as private student loans. If ISAs are not regulated as loans, do not have clear terms, or are "stacked" on top of federal and private loans, they will continue to deepen the crisis they purport to solve.

Addressing the student debt crisis will require broad-based forgiveness of federal student loans, significant improvements to federal repayment programs, and equitable or easily accessible discharge options. America's 45 million student loan borrowers need solutions that relieve the student loan burden, not new types of debt.

¹ For a more involved explanation about the definition of credit, see: Levitan, A. July 16, 2019. "What is 'Credit'? AfterPay, Earnin', and ISAs." *Credit Slips*. Available at <https://www.creditslips.org/creditslips/2019/07/what-is-credit-afterpay-earnin-and-isas.html>.

² Institutions of higher education such as Purdue University, Clarkson University, Flatiron Coding Bootcamp, Lambda Boot Camp, and Hack Reactor Boot Camp are offering ISA programs to their students.

³ Habash, T. & Kaufman, B. May 5, 2020. "As Coronavirus Crisis Rages, ISA Companies Ramp Up to Reap the Reward." *Student Borrower Protection Center*. Available at <https://protectborrowers.org/coronavirus-isa/>.

⁴ Center for Responsible Lending and National Consumer Law Center. November 2020. *Road to Relief: Supporting Federal Student Loan Borrowers During the COVID-19 Crisis and Beyond*. Available at <https://www.responsiblelending.org/research-publication/road-relief-supporting-federal-student-loan-borrowers-during-covid-19-crisis>.

⁵ Morgan, Darcus, & Habash. 2019, July 2. "Will Income-Share Agreements Be the Next Payday Loans?" *The American Prospect*. Available at <https://prospect.org/education/will-income-share-agreements-next-payday-loans/>.

⁶ The Truth in Lending Act (TILA) protects against inaccurate and unfair credit billing and credit card practices. It requires lenders to provide borrowers with loan cost information to allow for comparison shopping.

⁷ Morgan, Darcus, & Habash 2019.

⁸ Author calculations indicate that income-share agreements are likely to be more expensive than federal direct loans (both subsidized and unsubsidized), Parent PLUS Loans, and other private student loans. The authors attempted to estimate the total repayment amount for an undergraduate borrower with a loan size at graduation of \$10,000 with different loan types including Federal Direct Loans (both subsidized and unsubsidized), federal Parent PLUS Loans, private loans, and ISAs (represented by the Purdue Back-a-Boiler program) but were unable to duplicate external results due to opaque terms and thus chose not to publish the results. For one online ISA comparison that indicates the high cost of ISAs, see: Purdue's Back a Boiler ISA calculator and Comparison Tool at <https://www.purdue.edu/backaboiler/comparison/index.html>.

⁹ Morgan, J. M.; Farr, B.; & Hornung, D. January 10, 2019. "Income Share Agreements: A Student Debt Promise Falling Short of Reality." *Roosevelt Institute*. Available at <https://rooseveltinstitute.org/2019/01/10/income-share-agreements-a-student-debt-promise-falling-short-of-reality/>.

¹⁰ Federal Student Aid. "Student Loan Forgiveness." *United States Department of Education*. Accessed February 24, 2022. Available at <https://studentaid.gov/manage-loans/forgiveness-cancellation>.

¹¹ ISA terms are based on Purdue Back a Boiler ISA calculator (accessed 11/9/21) for General Communication major specifying: maximum allowable ISA advance amount, ISA rate, beginning median salary for graduates). See: <https://www.purdue.edu/backaboiler/comparison/index.html>. Assumptions include: ISA advance amount of \$18,500; starting salary of \$35,000 with an annual salary inflator of 104%; ISA pricing (percentage of annual salary per \$10,000) at 4.0%; 2021 Federal Poverty Level for a Single Adult at \$12,880 with an inflator of 102%; a maximum number of ISA payments at 112; federal student loan amount of \$31,000 with payments calculated as 10% of discretionary income; and discretionary income equaling actual salary less 150% of the poverty rate amount for a given family size. Additional documentation available at <https://www.purdue.edu/backaboiler/comparison/index.html>.

¹² ECOA prohibits any lender from discriminating against individuals on the basis of, among other reasons, their race, color, religion, national origin, sex, marital status, or age, either in credit availability or pricing. Before ECOA was enacted in 1974, creditors routinely rejected applicants for credit, based on inaccurate stereotypes about women, divorcees, and people of color.

¹³ Hinrichs, P. L. March 31, 2015. "Racial and Ethnic Differences in College Major Choice." *Federal Reserve Bank of Cleveland*. Available at <https://www.clevelandfed.org/newsroom-and-events/publications/economic-trends/2015-economic-trends/et-20150331-racial-and-ethnic-differences-in-college-major-choice.aspx>.

¹⁴ For instance, some institutions, such as Purdue University, regressively structure ISA programs so that English majors pay a greater income share than computer science majors, even though the latter has a higher expected income. This practice is not common, but as a leader in the nascent ISA field, Purdue's practices are noteworthy.

¹⁵ Student Borrower Protection Center. February 2020. *Educational Redlining*. Available at <https://protectborrowers.org/wp-content/uploads/2020/02/Education-Redlining-Report.pdf>.

¹⁶ Baylor, E. October 13, 2016. "Closed Doors: Black and Latino Students Are Excluded from Top Public Universities." *Center for American Progress*. Available at <https://www.americanprogress.org/article/closed-doors-black-and-latino-students-are-excluded-from-top-public-universities/>.

¹⁷ Student Borrower Protection Center, February 2020.

¹⁸ See 15 USC 1650(e).

¹⁹ Morgan, Farr, & Hornung January 10, 2019.

²⁰ Habash & Kaufman May 5, 2020.

²¹ This online poll was conducted between August 18 and September 2, 2020, among a sample of 500 North Carolina adults with student loans. Margin of error is plus or minus 4 percentage points. See: Center for Responsible Lending and Morning Consult. September 2020. *Poll of North Carolina Student Loan Borrowers*. Available at <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-poll-nc-studentloan-dec2020.pdf>. Borrowers were presented with the following two statements and asked to indicate which statement comes closer to their view: (1) "Income-driven repayment plans are already available for federal loans and ISAs may deny borrowers the protections that other student loans have. Additionally, adding ISAs to existing student debt loans may only exacerbate the financial stress during repayment;" and (2) "ISAs are an innovative financing tool that can help students fill the gaps they face in paying for college and may be available to students who are not eligible for federal or private loans or who have already taken out the maximum amount allowed."