INCOME SHARE AGREEMENTS AND HIGHER EDUCATION

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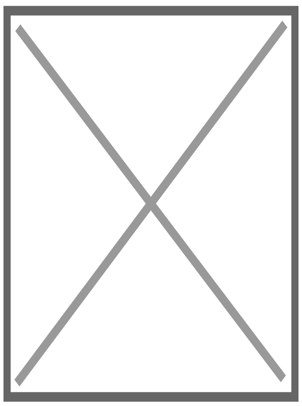
By: James Sattin



Knowledge is power. But what is knowledge worth? The Income Share Agreement ("ISA"), an old idea but increasingly popular financing model for higher education in America, is attempting to provide an answer. If one considers that the ISA market (both direct and secondary) is expected to rise to billions of dollars in just a few years, ISAs are worthy of examination both from a legal and civic perspective.

Generally speaking, an ISA is a contract whereby the lender finances the higher education of an individual in exchange for a percentage of that individual's post-graduation income, up to a capped figure and for an agreed number of years. An ISA is not a loan *per se*, as there is no principal balance. Neither is it a standard contract. Although modern ISAs remain a work in progress and in time will necessarily be forced to adapt to new legislation, in seeking to understand the theory behind them and their original intended application in American higher education, it is useful to go back to the beginning.

In 1955 the Nobel Prize winning economist Milton Friedman wrote an essay entitled "*The Role of Government in Education*", in which he separated education into two distinct groups: General Education and Vocational Education. The underlying purpose of General Education is to provide for better citizenship and social and political leadership – our Presidents ought to have read *Othello* and *Julius Caesar*. General Education may not be available to everyone (due to ability and cost), but it has a neighborhood effect in that it benefits all, not just those who possess it. Vocational Education, on the other hand, is directed at the investment in human capital for the purpose of increasing the economic productivity of the human being – our plumbers need not have read Shakespeare, although the man did excel at bathroom humor. According to Friedman, Vocational Education has no neighborhood effect.

Friedman calculated that the rate of return on investment in human capital far outstrips that of physical capital, ethical considerations notwithstanding, and it was to the benefit of both lender and student to engage in a "human equity" contract pursuant to which the student would have his Vocational Education financed by the lender in exchange for an "equity interest" in the student's future economic production – in essence an ISA.

Yale University experimented with a similar concept in the 1970’s with its Tuition Postponement Option, which was applied on a group wide basis rather than individually. The group structure resulted in gross overpayment by certain high-earning graduates to make up for the non-payment or underpayment by other graduates with low incomes, and the outstanding debt was finally cancelled in the early 2000’s amidst widespread alumni outcry. As a result of the need for academic institutions to raise revenue and fill classrooms – there were 2.4 million fewer college students in the United States in the fall of 2017 than there were in 2011 – the ISA has returned.

ISAs offer some definitive benefits. Perhaps the most important benefit from the perspective of the student debtor is that ISAs transfer part of the risk from the student to the lender. A standard student loan does not take into account the post-graduation income of the former student. Tuition at institutions of higher education are almost universally non-negotiable and uniform for every student (without factoring in scholarships), and the full amount of the loan, plus interest, is due no matter how much money the student earns after graduating. This may be a good deal for the high earner and a crushing burden for the low earner. Such is not the case with an ISA. The percentage of income owed may be constant, but the amount actually repaid to lender will vary from student to student and even from year to year for the same student. For many people, the decision of where to work following graduation is guided in large part by their student loan debt. With an ISA this is less likely to be the case, provided one can obtain financing under an ISA for study in their desired field.

Along with the benefits, there are also many potential issues associated with ISAs, as well as countless open questions. The most immediate issue is what the legal treatment of these contracts are and should be. The model ISA posted publicly by Purdue University, one of the first large national universities to adopt an ISA program, states that it is “not a loan or other debt or credit instrument” or “an assignment of wages”. Rather, “it represents your obligation to pay a specific percentage of your future earned income.” Legislatively speaking, there is little more clarity. Will it be treated the same as a standard student loan? What are the limits with respect to the term and amounts “loaned”, as well as to amounts repaid? What disclosures are required by the lenders under an ISA? Is it dischargeable in bankruptcy? Should there be federal or state oversight? None of these questions presently have definitive answers.

Marco Rubio and Todd Young (of Indiana, where Purdue is located) have introduced bills to regulate ISAs in 2014, 2015 and 2017 (the latest under the politically creative acronym ISSA – the “Investing in Student Success” Act). In each case the bills did not make it to a vote, which is a good thing because although the initiative to generate legislation regulating ISAs is valuable and necessary, the focus of these bills was on treating ISAs much like current student loans, which is unfortunate and inaccurate. However (better) legislation is required.

Beyond the contractual legal aspects, other questions persist. What should the ISA secondary market look like, and how should it be regulated? How should the law deal with discrimination in the offering and the terms of ISAs, particularly when private investment becomes even more involved than at present? Can the government force an ISA fund to be all-inclusive if the economic data points to certain groups, including racial and ethnic groups, as better, or safer, investments than others?

From a civic perspective, is there a risk that ISAs can change, and may ultimately set the value of an education? With years of hard data to work with, will a university charge the same tuition for an economics or engineering or pre-med degree as it does for philosophy or archaeology? Will this devalue certain professions and discourage potential difference makers in such fields? What will become of General Education, and of our social and political leaders? What will become of our society and culture when wall street refuses to fund poetry and art classes, and institutions of higher education can no longer afford to offer them? What is knowledge worth?

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