CATALYZING INNOVATION WITH REGULATION: INCOME SHARE AGREEMENTS AND THE STUDENT DEBT CRISIS

*Timothy Machat**

ABSTRACT

The use of Income Sharing Agreements to fund higher education is an innovative idea that can provide benefits for those facing the pervasive student debt crisis in the United States. Income Share Agreements allow investors to purchase a share of an individual's future earning prospects in exchange for advancing the student the funds needed to finance his or her education. The student recipient in turn agrees to pay the lender a specified fraction of his or her future earnings. The problem, however, is that without regulatory certainty, investors have been and will continue to be hesitant about participating in such arrangements, and Income Sharing Agreement programs will struggle to gain traction and grow. Legislators must work towards establishing a regulatory framework for this novel educational funding vehicle using select proposals from failed legislation and Purdue University's nascent "Back a Boiler" program as guidance. The prescribed action would facilitate increased exposure of a novel solution to the higher education funding quandary facing the nation's students and their families.

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* J.D. Candidate, Rutgers Law School, May 2018; B.A., Boston College, 2011. Articles Editor, *Rutgers University Law Review*. Thank you to Professor Marcia Crnoevich for her insight and guidance throughout the development of this Note. Thank you also to my family and friends for their continued support.

I. INTRODUCTION

It is no secret that the student debt crisis is one of the largest issues facing the United States as the country claws its way out of the economic recession.[1] Having borrowed heavily with hopes that a higher education would illuminate a proverbial light at the end of the economic recovery tunnel, many of America's rising generation of students have built up record debt in attempting to overcome a cycle of low wages and limited employment opportunities.[2] The $1.2 trillion in student debt that young Americans have accumulated as of the end of 2015 represents three times the amount from the previous decade.[3] In part, this problem is exacerbated by the fact that federal government loans have not managed to keep up with rapidly rising college tuition costs, and the burden of paying for the growing chasm between federal loans

1. *See* Jillian Berman, *America's Growing Student-Loan-Debt Crisis*, MARKETWATCH (Jan. 19, 2016, 2:11 PM), http://www.marketwatch.com/story/americas-growing-student-loan-debt-crisis-2016-01-15; Andrea Fuller, *Student Debt Payback Far Worse Than Believed*, WALL ST. J. (Jan. 18, 2017, 5:32 PM), https://www.wsj.com/articles/student-debt-payback-far-worse-than-believed-1484777880; Mark Kantrowitz, *Why the Student Loan Crisis is Even Worse than People Think*, MONEY (Jan. 11, 2016), http://time.com/money/4168510/why-student-loan-crisis-is-worse-than-people-think.

2. Barney Jopson, *Is the US Heading for a Student Debt Crisis?*, WORLD ECON. F. (Mar. 1, 2016), https://www.weforum.org/agenda/2016/03/is-the-us-heading-for-a-student-debt-crisis.

3. *Id.*; *see also* Kantrowitz, *supra* note 1 ("In 1993–94, about half of bachelor's degree recipients graduated with debt, averaging a little more than $10,000. This year, more than two-thirds of college graduates graduated with debt, and their average debt at graduation was about $35,000, tripling in two decades.").

and soaring costs has shifted from "federal and state governments to [students'] families."[4]

Students and families struggling with the obstacle of educational funding are forced to obtain costly alternatives, often with unfavorable terms and high interest rates.[5] In fact, recent lawsuits allege that the country's largest student loan servicer, Navient, has been misleading borrowers, driving up loan costs, and committing serious errors in "nearly every step of the collections process" for approximately one out of every four student borrowers in the country.[6] Naturally, the financial burdens facing recent graduates as a result of these loans is significant and lasting, with the potential to weigh down an individual's personal financial situation for years.[7] While a college degree is arguably still a sound investment, based on increased lifetime earnings and quality of life, many college graduates today have not realized outcomes that justify the expense.[8] Over 40% of students who begin working towards a degree fail to finish within six years, and even more students find themselves taking jobs that do not even require a college degree.[9]

Even the federal student-loan system itself is partly responsible for the seemingly hopeless situation in which many graduates—and more unfortunately, dropouts—find themselves in.[10] Because the federal system does not consider the returns on different academic programs when issuing loans, many students are left unaware of the value of the

4. Kantrowitz, *supra* note 1.

5. *See* Jillian Berman, *Would it Work in America? A Student Loan System that Protects People from Bad Luck*, MARKETWATCH (Nov. 27, 2015, 3:01 PM) [hereinafter Berman, *Would it Work in America*], http://www.marketwatch.com/story/would-it-work-in-america-a-student-loan-system-that-protects-people-from-bad-luck-2015-11-25.

6. Stacy Cowley & Jessica Silver-Greenberg, *Student Loan Collector Cheated Millions, Lawsuits Say*, N.Y. TIMES (Jan. 18, 2017), https://www.nytimes.com/2017/01/18/business/dealbook/student-loans-navient-lawsuit.html (comparing abuses of the student loan industry to those of the mortgage servicing industry, which resulted in systemic failures leading to the property foreclosures of the 2008 recession).

7. *See* Jopson, *supra* note 2 ("This has triggered concern that the level of student debt, which averaged just under $29,000 per borrower in 2014, up from $18,550 a decade earlier, will hold back many Americans' ability to start a business or buy a house."); Kantrowitz, *supra* note 1 ("[S]tudents who graduate with excessive debt are about 10% more likely to say that it caused delays in major life events, such as buying a home, getting married, or having children. They are also about 20% more likely to say that their debt influenced their employment plans, causing them to take a job outside their field, to work more than they desired, or to work more than one job.").

8. Miguel Palacios & Andrew P. Kelly, *A Better Way to Finance That College Degree*, WALL ST. J. (Apr. 13, 2014, 6:38 PM), http://www.wsj.com/articles/SB10001424052702303456104579485801253355622.

9. *Id.* ("[N]early 45% of recent college graduates were working in jobs that did not even require a degree . . . .").

10. *See id.*

financing options available to them.[11] For example, if a student enrolls in the ten-year repayment program, her monthly payment will constitute the highest percentage of her earnings in the period directly following graduation.[12] This leaves young graduates' earning potentials and financial welfares at the mercy of the (potentially ill-informed) decisions that they made in their late teens and early twenties.[13] For some, it digs a hole that can be very difficult to get out from.[14]

Additionally, the federal student-loan program provides universities with very little incentive to keep tuition low.[15] If loans are distributed liberally with little thought given or data provided about the return on investment, students and their families will gladly accept them, only to be blindsided upon repayment.[16] Furthermore, there are no uniform rules about helping struggling debtors, leaving an entire section of the population facing an amorphous and ominous financial situation.[17] The student loan crisis is in dire need of innovation and clarity, and borrowers are deserving of more options for financing their educations. One option that may have the potential to alleviate the crisis while simultaneously providing positive externalities that enhance consumer knowledge is the Income Share Agreement ("ISA").[18]

In essence, an ISA is an agreement whereby a student receives money to pay for school and then pledges to pay a fixed percentage of his or her income to the financier for a set amount of time once he or she enters the workforce.[19] Using ISAs to fund higher education is an innovative idea that can provide numerous benefits for those facing the pervasive student debt crisis in the United States. This Note will examine the origin of ISAs and their use in educational financing,

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11. *Id.*
12. *Id.*
13. *See id.*
14. *See id.*
15. *Id.*
16. *See id.*
17. *See* Jopson, *supra* note 2.
18. *See, e.g.*, AM. INSTS. FOR RES., THE POTENTIAL MARKET FOR INCOME SHARE AGREEMENTS AMONG LOW-INCOME UNDERGRADUATES, 1–2 (2015), http://www.air.org/sites/default/files/downloads/report/Income-Share-Agreements-ISAs-Potential-Among-Low-Income-Undergraduates-Sept-2015.pdf; MIGUEL PALACIOS, TONIO DESORRENTO & ANDREW P. KELLY, AMER. ENTER. INST., INVESTING IN VALUE, SHARING RISK: FINANCING HIGHER EDUCATION THROUGH INCOME SHARING AGREEMENTS 1–2 (2014), https://www.aei.org/wp-content/uploads/2014/02/-investing-in-value-sharing-in-risk-financing-higher-education-through-inome-share-agreements_083548906610.pdf; Kate Bachelder, *Escaping the Student-Debt Trap*, WALL ST. J. (Jun. 13, 2014, 6:41 PM), http://www.wsj.com/articles/the-weekend-interview-escaping-the-student-debt-trap-1402699281.
19. *Income Share Agreements*, PURDUE.EDU, https://www.purdue.edu/dfa/types-of-aid/income-share-agreement/index.html (last visited Mar. 1, 2018).

discuss the advantages of implementing ISAs in the higher education sphere, and explain why this concept has failed to expand to a size that would significantly impact the student loan crisis.

Due to the relatively novel concept of the ISA and its limited historical use in the educational context, little regulation of this financial instrument exists.[20] ISAs currently function in a "legal gray zone," as "[n]o major regulators have drafted rules specifically to address them."[21] The problem is, without regulatory certainty, investors will be hesitant to participate in such arrangements, and ISA programs will struggle to gain traction and grow, thus failing to help alleviate the student debt crisis.[22] Consequently, it is imperative that legislators establish a regulatory framework for this new educational funding vehicle using the concepts from proposed legislative efforts and pioneering private endeavors. This Note will then assess the few regulatory proposals that have been offered for ISAs, as well as Purdue University's nascent "Back a Boiler" program,[23] to determine their suitability as guides for developing a regulatory framework that facilitates the large-scale integration of ISAs into higher education funding. By tailoring a regulatory framework for ISA programs, legislators will provide the means for the proliferation of a novel solution to the higher education funding quandary facing the nation's students and families.

II. WHAT ARE ISAS?

The concept of the Income Share Agreement was developed by economist Milton Friedman in 1955, when he noted that many individuals who wished to pursue secondary schooling lack the means to do so without generous contributions from family members and charitable individuals.[24] Pondering the methods of financing secondary education, he concluded that traditional loans are a poor vehicle for this purpose, given their risk and the lack of collateral that creditors receive.[25] Instead, Friedman suggested "'buy[ing]' a share in an

20. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 11–12.

21. Stacy Cowley, *Getting a Student Loan with Collateral from a Future Job*, N.Y. TIMES (Apr. 8, 2016), http://www.nytimes.com/2016/04/09/business/dealbook/getting-a-student-loan-with-collateral-from-a-future-job.html?_r=0.

22. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 12.

23. *See generally Back a Boiler–ISA Fund*, PURDUE RES. FOUND., http://purdue.edu/backaboiler (last visited Mar. 1, 2018).

24. *See* Milton Friedman, *The Role of Government in Education*, *in* ECONOMICS AND THE PUBLIC INTEREST 123, 135–43 (Robert A. Solo ed., 1955).

25. *Id.* at 137.

individual's earning prospects[] to advance him the funds needed to finance his training on condition that he agree to pay the lender a specified fraction of his future earnings."[26] Friedman's idea, while not embraced fully, set the foundation for ISA programs of the future.[27]

A different, but also cogent way of conceptualizing the kind of agreement that Friedman considered in 1955 is "working your way through college, after college."[28] Rather than dedicating essentially all of their in-college earnings to tuition, individuals may postpone that work until graduation and allocate a lesser percentage of a markedly higher income towards paying back the "loan" that they received.[29] Using a fixed rate linked to income expectations, students begin repaying the debt upon graduation.[30] If the student enjoys a high salary, the amount that the student pays back may be more than originally borrowed.[31] Conversely, a student earning a low wage may ultimately repay less than the amount originally borrowed.[32]

III. CURRENT IMPLEMENTATION OF ISAS IN EDUCATIONAL FUNDING

A. *13th Avenue Funding*

There have been a handful of privately operated ISA programs aimed at funding the college educations of individuals, each with its own nuances and terms. 13th Avenue Funding ("13th Avenue") recognized the borrowing "trap" that currently exists for students, and developed a concept to finance an education using community-controlled, equity-based funding without the burdens of debt.[33] It built its ISA model following the basic premise that had been tested in

26. *Id.* at 138.
27. Jeff Schwartz, *The Corporatization of Personhood*, 3 U. ILL. L. REV. 1119, 1125 (2015).
28. Chelsea Schneider, *Purdue's 'Back a Boiler' Program Up and Running*, INDYSTAR (Jun. 20, 2016, 2:00 PM), http://www.indystar.com/story/news/education/2016/06/20/purdues-back—boiler-program-up-and-running/85972758.
29. *See* Danielle Douglas-Gabriel, *At Purdue, Student Aid Based on Future Earnings Could Revolutionize College Debt*, WASH. POST (Apr. 11, 2016) [hereinafter Douglas-Gabriel, *At Purdue*], https://www.washingtonpost.com/news/grade-point/wp/2016/04/11/at-purdue-student-aid-based-on-future-earnings-could-revolutionize-college-debt.
30. *Id.*
31. *Id.*
32. *Id.*
33. *A New Way to Pay for College*, 13TH AVENUE FUNDING, http://www.13thavenuefunding.org (last visited Mar. 1, 2018) ("Defaulting on your student loans creates significant problems. It hurts your credit rating, makes it more difficult to get a job and, the longer you wait to pay it off, the more it will end up costing.").

Australia and Europe.[34] Underlying 13th Avenue's model is the concept of successful college graduates reinvesting into the community, and the notion that the current student loan environment results in fewer successful graduates being able to do so.[35] The essence of the venture is the notion that "[y]ou only owe if you are making money—if you are out of work, you don't owe," an idea common to ISA programs.[36] What makes 13th Avenue appealing compared to traditional funding options is that "[a]ffordability is built in."[37] Additionally, a cap is built into the agreement, so borrowers need not pay back exorbitant amounts, should they achieve inordinately high earnings.[38] At the same time, the 13th Avenue Model also seeks to appeal to investors, with a goal of returning a 2% premium over the initial capital.[39]

B. Vemo Education

Vemo Education, founded in August 2015, operates an income-based program with the goal of best utilizing institutional resources and "align[ing] the cost of a student's education with its value."[40] At the root of the student debt crisis, Vemo management believes, is a lack of value that creates dissonance between the students and the lenders.[41] Vemo works with higher education institutions to develop income-sharing programs that synchronize the motives of each party and shift some of the outcome risk from students to the institution, thus aligning the cost of attendance with the success students achieve upon graduation.[42] Vemo's platform is likened to both a loan and an insurance policy because students borrow with the intention of repayment, but they are

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34. *Our Pilot,* 13TH AVENUE FUNDING, http://www.13thavenuefunding.org/our-pilot (last visited Mar. 1, 2018).

35. *See A New Way to Pay for College, supra* note 33.

36. *Id.*

37. Cowley, *supra* note 21 (quoting 13th Avenue chief executive Robert M. Whelan, Jr.).

38. JON MARCUS, AMER. ENTER. INST., STUDENTS' FUTURES AS INVESTMENTS: THE PROMISE AND CHALLENGES OF INCOME-SHARE AGREEMENTS 1, 9 (2016), https://www.aei.org/wp-content/uploads/2016/03/Students-Future-as-Investments.pdf.

39. *Id.*

40. *About Vemo,* VEMO, http://vemo.com/about-vemo (last visited Mar. 1, 2018).

41. Matt Ottinger, *Backing the Future: Purdue Ponders Innovative Funding Initiative,* BIZVOICE, Mar./Apr. 2016, at 30, http://www.bizvoicemagazine.com/media/archives/16marapr/IncomeShare.pdf ("We think the student debt crisis at its root isn't one of debt, but of value . . . . If you look at a student loan . . . the relationship it creates between the students and the provider of finance — it doesn't align them all." (quoting Vemo CEO Tonio DeSorrento)).

42. *Our Approach,* VEMO, http://vemo.com/our-approach (last visited Mar. 1, 2018).

not liable if they struggle financially after graduation.[43] The company touts its income-based approach as providing benefits to both students and institutions.[44]

C. Lumni

Perhaps the most established venture engaging in ISA-based educational funding is Lumni.[45] The self-described pioneer of the fledgling human capital financing field[46] was cofounded by Vanderbilt University professor and ISA advocate Miguel Palacios in 2002.[47] Conducting much of its business in South America, its Spanish-language website boldly proclaims the tagline, "Financiamos hoy tu éxito profesional de mañana," loosely translating to "We will finance today your professional success of tomorrow."[48] Interestingly, Palacios was inspired to start Lumni by musician David Bowie, who in 1997 financed the production of his next album by offering shares of future revenue.[49] Palacios applied the concept to promising young students, and as of August 2015, Lumni had made approximately 7000 loans to students in four South American countries.[50] In addition to enabling thousands of students to pursue their degrees, the institutional fund has realized a rate of return of between 10% and 15%.[51] In its pilot rendition of the program, Lumni funded four Chilean students, offering ISAs of about $12,000 in exchange for approximately 3% of the students' income for the five years following graduation, which was viewed as being successful by students and investors alike.[52] Lumni's model incorporates the notion that investors receive a social return as

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43. Ottinger, *supra* note 41, at 30.

44. *Our Approach*, *supra* note 42 ("Aligns education cost with value; Leverages existing institutional resources; Provides out-of-pocket relief families are seeking NOW; Enables students to pay a fixed [percentage] of their income; Introduces a new enrollment management tool; Creates a new revenue stream.").

45. MARCUS, *supra* note 38, at 9.

46. *About Lumni*, LUMNI, http://www.lumni.net/en/about (last visited Mar. 1, 2018).

47. Bachelder, *supra* note 18.

48. *Home*, LUMNI, http://lumni.net (last visited Mar. 1, 2018).

49. Bachelder, *supra* note 18; *see also* Phil Rosenthal, *Bowie Bonds: When the Man Who Sold the World Sold Asset-Based Securities*, CHI. TRIB. (Jan. 11, 2016, 3:42 PM), http://www.chicagotribune.com/business/columnists/ct-rosenthal-david-bowie-bonds-0112-biz-20160111-column.html; Ethan Wolff-Mann, *Bowie Bonds: How David Bowie Securitized His Royalties and Predicted the Future*, MONEY (Jan. 11, 2016), http://time.com/money/4175086/david-bowie-bond-royalties-securitized.

50. Douglas Belkin, *More College Students Selling Stock—In Themselves*, WALL ST. J. (Aug. 5, 2015, 12:26 PM), http://www.wsj.com/articles/more-college-students-selling-stockin-themselves-1438791977.

51. *Id.*

52. Bachelder, *supra* note 18.

well as a financial one,[53] and the company "has raised about $50 million from individuals, corporations, and foundations."[54] Lumni's idea that investors are receiving returns with a purpose is an appealing one that may help attract widespread popularity for ISA programs in the United States.[55]

D. Education Equity

Education Equity, Inc. ("EEI"), based in Chicago, is a unique "specialty finance company" that offers ISA options for financing secondary education.[56] Much like Vemo, EEI stresses the alignment of investor and student interests, and describes its financing method as "co-invest[ing] with students to support their pursuit of cost-effective education and rewarding careers."[57] EEI, again like Vemo, describes the return to investors as significant financially while also providing a benefit to society.[58] In order to provide funding that is a prudent investment for both students and investors, EEI uses data from universities and the labor market to determine the most cost-effective educational programs.[59] EEI founder Andrew Davis has been limited by the lack of legal clarity surrounding ISAs, thus limiting investors to family and friends, with the hopes of expanding in the future.[60] However, his venture has already been a force for good in the lives of community members. One borrower of EEI's funding was a teacher who wished to return to school, but due to a bankruptcy years earlier, could not even secure a credit card, much less a student loan.[61] EEI advanced the individual $10,000 to pursue a master's degree in exchange for payment of 5% of his income for the five years following graduation.[62]

53. *See About Lumni*, *supra* note 46 (graphic); Bachelder, *supra* note 18 ("The [recent] returns have been lower, by design . . . . [M]any [investors] have simply liked the work we do and asked for little or no return.").

54. Bachelder, *supra* note 18.

55. *Id.*

56. *Consumer Finance: Company Overview of Education Equity, Inc.*, BLOOMBERG, https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapid=224596122 (last visited Mar. 1, 2018).

57. *Who We Are*, EDUC. EQUITY, INC., http://educationequityinc.com/who-we-are (last visited Mar. 1, 2018).

58. *Id.*; *see also Mission*, EDUC. EQUITY, INC., http://educationequityinc.com/about/mission-values-and-ethics (last visited Mar. 1, 2018) ("The Mission of Education Equity, Inc. is to increase human capital and support positive social mobility by identifying, funding and guiding students in their pursuit of cost effective higher education.").

59. *Who We Are*, *supra* note 57.

60. Belkin, *supra* note 50.

61. *Id.*

62. *Id.*

The teacher, a principal with his master's degree completed, extols the enterprise for giving him an option when he felt he had none.[63] Given EEI's potential to provide opportunity to those who seemingly had none, Davis stresses the need for regulation to continue the program.[64] Echoing the sentiments of other leaders and potential investors in the burgeoning industry, he stressed that "[t]he market could use . . . guidelines," because backers are awaiting guidance before the market bursts into the mainstream.[65]

E. Private ISA Experiments

Two other investment firms, Upstart and Pave, experimented with ISAs for student borrowers in 2012, but neither program took off, and both abandoned the ISA components of their business models in 2014.[66] Pave, which required funding recipients to be at least eighteen years old to borrow, used historical data to project an individual's future income to negotiate a percentage of income that was to be paid.[67] The contracts generally called for the payment of income percentages for ten years, with a maximum of 10% of annual income, and borrowers were free from their payment obligations if their income fell below 150% of the poverty line.[68] Upstart offered similar contracts, with a cap on payments at 7% of income for a ten-year span,[69] but investors were hesitant about uncertain returns and students were unsure of how to value their future labor.[70] While executives at Upstart are still "huge fans of [ISAs], and their potential to provide a better means of paying for college and funding aspiring entrepreneurs," regulatory concerns halted the development of the market.[71] Despite what Upstart CEO

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63. *Id.* ("I was running out of options . . . . This was a great route for me.").

64. Lauren Camera, *The Wild, Wild West of Tuition Assistance*, U.S. NEWS & WORLD REP. (Apr. 21, 2016, 5:13 PM), http://www.usnews.com/news/articles/2016-04-21/the-wild-wild-west-of-tuition-assistance.

65. *Id.*

66. Cowley, *supra* note 21 (noting that each switched to more conventional loans due to reluctant investors and borrowers concerned with uncertainty of returns and valuation of labor).

67. Tara Siegel Bernard, *Program Links Loans to Future Earnings*, N.Y. TIMES (July 19, 2013), http://www.nytimes.com/2013/07/20/your-money/unusual-student-loan-programs-link-to-future-earnings.html.

68. *Id.* (stating that, according to the co-founder, Pave "built a contract that balances both sides very well," and "[t]hat investors take full downside and full upside").

69. *Id.*

70. Cowley, *supra* note 21.

71. Dan Ritter, *Upstart: An Elegant Lending Platform for a More Civilized Age*, CHEAT SHEET (Nov. 7, 2014), http://www.cheatsheet.com/business/upstart-an-elegant-lending-platform-for-a-more-civilized-age.html/?a=viewall.

Dave Girouard describes as a warm reception to the ISA concept from a policy perspective, he worries that the policy efforts may take years to be completed, and explained that a start-up venture like his does not have the time to wait.[72] These remarks, mirroring the sentiments of many others in the industry, demonstrate the urgent need for regulation pertaining to ISA agreements to ensure that these valuable financing options are available to the current generation of college students.[73]

F. Oregon's "Pay it Forward" Plan

In addition to private enterprises experimenting with ISAs, Oregon has become the first state in the United States to institute a state-backed program, while about half the states are studying the idea.[74] In 2013, the Oregon state legislature tested the waters when it initiated its "Pay it Forward" plan.[75] The "Pay it Forward" plan embraced an "evergreen" model in which the state was the investor and merely charged enough to replenish the pool of funds for reinvestment, to be continued cyclically.[76] The Oregon program has faced its share of logistical obstacles.[77] Given its nature as a state-funded program, concern has been raised over how to fund the $5 million to $20 million it is estimated to cost each year to get the program off the ground.[78] The program is not projected to be self-funding until its twentieth year.[79]

G. Australia's ISA Plan

Overseas, Australia has employed an income-contingent student loan program since 1989 with significant success.[80] The Australian

72. *Id.*

73. *See id.*

74. Paula Dwyer, *Rubio's College-Cost Plan Deserves a Chance*, BLOOMBERG (Dec. 2, 2015, 8:00 AM), https://www.bloomberg.com/view/articles/2015-12-02/rubio-income-share-plan-can-work-better-than-college-loans.

75. Palacios & Kelly, *supra* note 8.

76. MARCUS, *supra* note 38, at 8.

77. Jacy Marmaduke, *'Pay It Forward' Tuition Program Needs More Planning, House Panel Says*, THE OREGONIAN (June 9, 2015, 4:08 PM), http://www.oregonlive.com/politics/index.ssf/2015/06/pay_it_forward_tuition_program.html ("[T]he program needs a more detailed plan before it can proceed."); *see also* PAY IT FORWARD WORKGROUP, HOUSE BILL 3472: PAY IT FORWARD (2014) (draft report), http://perma.cc/VW65-M7VK.

78. Marmaduke, *supra* note 77.

79. *Id.*

80. Andrew Norton, *Australian College Plan Has Helped Students, at a Cost*, N.Y. TIMES (July 11, 2013, 1:52 PM), http://www.nytimes.com/roomfordebate/2013/07/09/study-now-pay-later/australian-college-plan-has-helped-students-at-a-cost; *see also* Susan

program functions by simply charging between 4% and 8% of graduates' income until the tuition loans are paid off.[81] The government collects the payments directly from borrowers' paychecks, similar to how payroll taxes are withheld in the United States.[82] Noting that "unfortunate and adverse and uncontrollable events" may prevent some individuals from fully capitalizing on their educational investment, graduates who are not employed or experience unforeseen economic hardship are generally free from their payment obligations.[83] Additionally, borrowers are only required to pay back the loan if their income surpasses a threshold value of around $44,000 per year.[84] Inspired by Friedman's original concept, Australian officials had to improvise the translation of the pioneering idea into reality due to the lack of established precedents.[85] Fortunately for any government entities or private enterprises that attempt to construct an ISA program today, there are now nearly three decades of empirical data and policies to consider in developing terms.[86]

IV. CONSTITUTIONAL CONCERNS ABOUT ISAS

While some enterprises and governments have embraced ISAs, many others fret about the nature of the agreements.[87] The notion of "human equity investing" discomforts some who see it as a type of ownership of personhood.[88] Friedman himself commented that investing in the economic output of individuals may approach the boundaries of "partial slavery."[89] The purchase of future interests in an individual can be seen as buying stock, much like one may buy stock in a corporate

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Dynarski, *America Can Fix Its Student Loan Crisis. Just Ask Australia.*, N.Y. TIMES (July 9, 2016), http://www.nytimes.com/2016/07/10/upshot/america-can-fix-its-student-loan-crisis-just-ask-australia.html?_r=0.

81. Berman, *Would it Work in America*, *supra* note 5 ("'I was trying to think of a way whereby you could protect people from bad luck,' said Bruce Chapman, an economist at the Crawford School of Public Policy at the Australian National University and the architect of the country's student loan program.").

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.* ("We didn't have another country to look at or a paper to look [at] so we just kind of made it up.").

86. *See id.*

87. Friedman, *supra* note 24, at 135 ("It is a form of investment in human capital precisely analogous to investment in machinery, buildings, or other forms of non-human capital."); Schwartz, *supra* note 27, at 1122 ("[O]wning the right to another's future income suggests a neo-feudalistic relationship that is in the same vein [as slavery].").

88. Schwartz, *supra* note 27, at 1121.

89. Friedman, *supra* note 24, at 138.

entity.[90] Shareholders of a corporate entity are seen as owners of part of the corporation in which they hold stock, so those who hold stock in individuals can be construed as owners of people, thus creating unsavory analogies to slavery.[91]Perhaps failing to understand the nuances of ISAs and focusing merely on the facial impressions elicited by comparisons to slavery and indentured servitude, some oppose the concept of ISAs.[92] Detractors of ISAs suggest that the funding mechanisms may violate both the Thirteenth Amendment prohibition of slavery and public policy.[93]

The Thirteenth Amendment explains that "[n]either slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States."[94] Key to understanding this provision are the definitions of "slavery" and "involuntary servitude." As it is written in the Constitution, "slavery" is understood to mean the "institution of African slavery" of the Civil War era.[95] "Involuntary servitude," as used in the Amendment, refers to forms of "compulsory labor akin to African slavery,"[96] and "situations in which labor is compelled by physical coercion or force of law."[97]

Clearly, African slavery is not a factor in ISA educational funding agreements. Furthermore, the way ISAs are structured, funding recipients must pay a proportion of income, but they are not compelled to work.[98] Should borrowers fail to reap an income, the lenders have no recourse.[99] However, the failure of borrowers to seek employment is unlikely. Individuals will seldom, if ever, intentionally avoid earning an income solely to avoid paying 5% of it back to their lenders.

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90. Schwartz, *supra* note 27, at 1135.
91. *Id.* at 1135–36.
92. *See id.*
93. *Id.* at 1135.
94. U.S. CONST. amend. XIII, § 1.
95. United States v. Kozminski, 487 U.S. 931, 942 (1988).
96. *Id.* (quoting Butler v. Perry, 240 U.S. 328, 332 (1916)).
97. *Id.* at 943 ("[O]ur precedents clearly define a Thirteenth Amendment prohibition of involuntary servitude enforced by the use or threatened use of physical or legal coercion. The guarantee of freedom from involuntary servitude has never been interpreted specifically to prohibit compulsion of labor by other means, such as psychological coercion.").
98. Berman, *Would it Work in America*, *supra* note 5.
99. *See id.*

V. ADVANTAGES OF ISAS

Given the clear distinction between ISAs and Thirteenth Amendment slavery, ISAs can serve as an ideal vehicle to finance higher education, boasting several advantages for students considering utilizing them. Under the current student loan system, there are dual victims of defaulted repayment.[100] The "self-inflicted wound" imparted by the federal government afflicts taxpayers, who must compensate for the government's failed investment in its rising generation of human capital, and distresses the students who borrow the funds and are unable to make payments.[101] Many of these student borrowers face the devastating impact of both practical setbacks and psychological trauma as they are straddled with the notions of failure and despair while also being burdened with a slate of heavy debt.[102] Moreover, the dysfunction of the current student loan system, despite efforts to provide educational accessibility to all, falls heavily upon the poor.[103] While students from more privileged backgrounds and socioeconomic circumstances may have family and community connections to fall back on for financial assistance and employment opportunities, those in lower tax brackets are ill afforded those luxuries, and loan default can become inevitable.[104] Hence, the notion of educational institutions having "skin in the game" by sharing in the profits and losses of students facing loan repayment offers an equitable opportunity for students to reduce the incidence of default.[105]

From the student perspective, ISAs offer freedom that is seldom enjoyed by those who are burdened with traditional loans for years after graduation. In the case of a typical student loan, graduates receive a grace period of six months after graduation before they are required to

100. Richard Vedder, Ctr. for Coll. Affordability & Productivity, *Equity vs. Efficiency: Downsizing Student Loans*, FORBES (Dec. 7, 2015, 11:24 AM), http://www.forbes.com/sites/ccap/2015/12/07/equity-vs-efficiency-downsizing-student-loans/#231e6da95f1d.

101. *Id.*

102. *Id.*

103. *Id.* ("Federal financial assistance policies however are so dysfunctional that we today have a system where the proportion of recent college graduates from low income backgrounds is smaller than in 1970, but we have extreme *inefficiency* as well—the poor are hurt at a high cost to all.").

104. *See id.*

105. *Id.* ("[E]ducational providers should have skin in the game—they should share, in some meaningful way, the financial losses associated with students defaulting on loans. Some irresponsible admission of highly marginal students would be adverted as schools scramble to minimize the proportion of their student borrowers who fail to repay their loan obligations. Done correctly, this alone would dramatically reduce the loan delinquency and default problem.").

start making payments.[106] Consequently, new graduates have very little time to secure employment after graduation to enable them to start paying off their loans. Further, the employment that borrowers attain must immediately provide income sufficient to make a full loan payment each month, at the risk of falling behind and letting the phenomenon of compounding interest work its magic.[107] Unsurprisingly, it is very easy for new graduates to quickly fall behind on their loan payments, triggering a domino effect that will diminish their credit rating and hinder them years down the road when such milestones as buying cars or homes arise. The ISA, by virtue of its makeup, relieves new graduates of these universal pressures.

While some may erroneously argue that ISAs constitute a form of slavery or indentured servitude, it is ironically the traditional lending model that currently shackles the nation's young adults.[108] With a finite amount of time to situate themselves for their financial futures, graduates must often settle for the first job—rather than the right one.[109] Perhaps they must settle for a steady but dead-end position, rather than a riskier opportunity with higher upside.[110] Their employment prospects may be limited by the amount of risk they can incur, while shelving entrepreneurial pursuits.[111] ISAs, however, allow those same graduates to pursue riskier endeavors that may provide significant payoffs in the future, which certainly would not have been options in the traditional student lending context.[112]

Ironically, with what their detractors like to analogize to indentured servitude, ISAs present graduates with more autonomy than they would enjoy otherwise. As important as any other benefit

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106. *Understanding Repayment*, FED. STUDENT AID, https://studentaid.ed.gov/sa/repay-loans/understand#grace-period (last visited Mar. 1, 2018).

107. *The Power of Compounding Interest*, LENDKEY, http://www.lendkey.com/resources/the-power-of-compounding-interest-2 (July 29, 2015) ("Compounding interest occurs when the amount of interest accrued on a loan is added back to the principal. Once the accrued interest has been added to the principal, or 'compounded,' it begins to accrue its own interest. Over time, compounding interest can dramatically increase the cost of a loan.").

108. *See* Kevin J. James & Rooney Columbus, *No, Income Share Agreements Are Not Indentured Servitude*, AMER. ENTER. INST. (Feb. 6, 2015, 4:22 PM), https://www.aei.org/publication/income-share-agreements-indentured-servitude; Schneider, *supra* note 28 (Former Indiana governor and current Purdue University President Mitch Daniels argues, "[I]ndentured servitude is the student debt of today—that is indentured servitude . . . . [While with an ISA] the student is totally free, they don't have to work at all. If they don't, they just walk, and it's the investor who loses.").

109. *See* Kantrowitz, *supra* note 1.

110. *See* James & Columbus, *supra* note 108.

111. *See id.*

112. *See id.*

that ISAs provide is the fact that they afford students freedom.[113] Students are free to establish any career practice they wish.[114] Should their dream career fail to realize the income envisioned, borrowers are immediately blessed with a built-in fresh start to pivot career paths without severe financial consequence.[115] In essence, ISAs can free student borrowers from the omnipresent anxieties of market conditions and the pressure of immediate earnings. However, the list of freedoms offered to recipients of ISAs is not exhausted merely at the topic of employment.

ISA recipients are blessed with the opportunity to choose their courses of study along with their preferred personal and familial aspirations.[116] This means that graduates have the option to return to graduate school or start a family and stay home with their children without the pressures of maintaining a constant and steady income to afford loan payments.[117] If a borrower is stricken with an unfortunate illness or a disability that prevents him or her from working, the ISA, by its very nature, allows that individual to stop making payments.[118] There is no principal accruing interest; rather, there is an obligation to make an agreed-upon number of payments at an agreed-upon percentage of income, whenever the individual begins earning again.[119]

The risk-shifting nature of ISAs make them particularly attractive to students who are hesitant to commit to tens of thousands of dollars of loans.[120] Rather than betting solely on one's own ability to monetize the education in which he or she has invested, the risk of investing is shouldered by ISA providers.[121] While individuals financing their own education are clearly accountable for their own performance and banking exclusively on their own success, ISA providers have the luxury of investing in a larger pool of students, diversifying the risk.[122]

113. *See id.* ("This gets to the heart of what ISAs offer students. They are not about control, but instead grant students freedom from the constraints, anxiety, and financial risk that accompany traditional loans.").

114. *The Other Debt-Free College Idea*, WALL ST. J. (Apr. 17, 2016, 6:12 PM), http://www.wsj.com/articles/the-other-debt-free-college-idea-1460931141.

115. *See id.*

116. *See* Kim Clark, *Now You Can Sell Shares in Yourself to Pay for College*, TIME (Nov. 16, 2016), http://time.com/money/4568213/income-share-agreements-college.

117. *See id.*

118. *See id.*

119. *Id.* ("[T]he principal won't keep growing the way a loan does. In [one student's] case, once she's made 100 payments of 4.3% of her income, she'll be free and clear.").

120. *See* James & Columbus, *supra* note 108.

121. *See id.*

122. *Id.*; *see also* Danielle Douglas-Gabriel, *Investors Buying Shares in College Students: Is This the Wave of the Future? Purdue University Thinks So*, WASH. POST (Nov. 27, 2015), https://www.washingtonpost.com/news/grade-point/wp/2015/11/27/investors-

This, additionally, provides little reason for the investors to meddle in the affairs of the students whom they sponsor or to scrutinize students' potential before funding them, since, in order to profit, they only depend on the average success of students.[123]

Another advantage of ISAs in comparison to traditional student loans is the ability to raise one's credit score without risk.[124] While traditional loans limit the returns lenders may receive, they also place too much risk on the borrowers.[125] The resulting situation is a dearth of credit for lenders and an excess of risk and stress for students whose financial well-being will be severely strained if their income is not immediately sufficient to make payments on a principal that is steadily accruing interest.[126] Investments made in this type of credit environment generally take the form of equity vehicles analogous to the ISA agreements that they inspired.[127] Student credit is generally not assessed in the application of the ISA because there is no principal to be paid back.[128] Similarly, if a student takes time off, is laid off, or cannot work and make payments for any reason, given that no loan was ever made, and therefore no debt is technically owed, the student's credit score will remain unaffected.[129] This overlooked luxury can help students avoid the cyclical hardship of bad credit throughout their lives.[130]

Moreover, ISAs may appeal to students empathetic to the hardships of peers entering similar situations because they can fund their own education while simultaneously "returning the favor" to students who follow in their footsteps.[131] ISA funds following the "evergreen" model,

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buying-shares-in-college-students-is-this-the-wave-of-the-future-purdue-university-thinks-so/?utm_term=.e1a037871963 ("By pooling agreements, investors could hedge against graduates who might wind up with low earnings or lose their job . . . .").

123. James & Columbus, *supra* note 108.

124. Divya Raghavan, *How Student Loans Affect Your Credit Score*, U.S. NEWS & WORLD REP. (July 7, 2014, 8:41 AM), http://money.usnews.com/money/blogs/my-money/2014/07/07/how-student-loans-affect-your-credit-score ("Defaulting often triggers serious repercussions that could leave [students] with a damaged credit history and seriously impede [their] ability to get started in life as [] working adult[s].").

125. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 1.

126. *Id.* ("On the lender side, this means that the private student-loan lenders undersupply credit (even for students with good prospects) without some kind of government guaranty or subsidy.").

127. *Id.*

128. *See* MARCUS, *supra* note 38, at 9.

129. *Id.* at 7.

130. *See id.*

131. *See id.* at 2 ("Some advocates say that ISAs represent capitalism with a higher purpose, offering a chance to invest not in tech stocks or commodities futures, but in people's lives.").

such as the Oregon "Pay it Forward" program, give students the opportunity to pay for school with a philanthropic twist.[132] The greater the student participation is in such programs is, the larger the returns are for reinvestment into additional students' educations may be.[133]

While students stand to benefit greatly from increased adherence to ISA funding in higher education, they are not the only beneficiaries.[134] Taxpayers would also be spared from the increasingly heavy burden that they are lifting given the trend toward student loan default.[135] Recently implemented income-based repayment plans have been rolled out to alleviate the burden on borrowers.[136] These repayment plans, like ISAs, allow debtors to pay a more manageable monthly payment, which is calculated as a percentage of monthly income.[137] The "Pay as You Earn" program has been touted as one of the most generous programs introduced to alleviate student debt obligations, and it mandates that borrowers pay 10% of their discretionary income each month.[138] The program has contributed to a significant reduction in defaults from student borrowers.[139] However, these loan repayment plans diverge from ISAs in that they are functionally just a vehicle for debt forgiveness, and the bill is being passed on to taxpayers.[140] ISAs allow for affordable payments without additional taxpayer spending.[141] While students can enjoy the safeguards from predatory lending and make affordable repayments, taxpayers will not be responsible for the repayment of loans or the recovery of losses by investors.[142]

Along with the practical advantages of ISAs for the participants on both the receiving and lending ends of the transactions, positive

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132. *See id.* at 8.
133. *See id.*
134. *See* Belkin, *supra* note 50.
135. *Id.*
136. *Id.*
137. *Id.*
138. Josh Mitchell, *The Ballooning Cost of Obama's College-Loan Repayment Program*, WALL. ST. J.: REAL TIME ECONOMICS (Jan. 20, 2015, 8:44 PM), http://blogs.wsj.com/economics/2015/01/20/the-ballooning-cost-of-obamas-college-loan-repayment-program ("[I]t requires borrowers to pay 10% a year of their discretionary income—annual income above 150% of the poverty level—in monthly installments.").
139. Josh Mitchell, *Defaults on Federal Student Loans Decline*, WALL ST. J. (Sept. 24, 2014, 7:22 PM), http://www.wsj.com/articles/defaults-on-federal-student-loans-decline-1411567201.
140. Belkin, *supra* note 50 ("Enrollment in income-based repayment plans has been so strong that some critics worry that taxpayer costs are getting out of hand."); *see also* Mitchell, *supra* note 139 ("The plans promise to forgive debt after a set period—10 years for those in nonprofit and government jobs, and 20 years for those in the private sector.").
141. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 2.
142. *See* Dwyer, *supra* note 74.

externalities will arise for the students, investors, and the entire market. Since investors and students share common goals—high academic performance, successful completion of a college degree, comfortable earnings, and financial security—resourceful investors may feel pressure to provide additional assistance to ensure the students' realization of these goals.[143] A natural incentive is provided for investors to connect the students in whom they invest with tutors, academic advisors, and career counselors during and after their college years.[144] In financing their education in this unique, debt-free way, students are also potentially linking themselves with a network of support they otherwise may not have had access to.

Additionally, ISA funding programs will likely have the effect of reducing dropout rates at universities and introducing market forces that effectively raise the value of post-secondary education as a whole. Of students who began their studies in 2008, only 62.85% completed their four-year degree within a six-year window.[145] According to the Organization for Economic Co-Operation and Development, the United States finished last for the number of students who completed a four-year degree once they started it, out of the eighteen industrialized countries that it tracked.[146] The reasons for this staggering incidence of dropout are varied, but include, unsurprisingly, financial pressures and familial obligations.[147] A Harvard study notes that an additional explanation for this troubling statistic is the students' inability to see a "clear, transparent connection between their program of study and tangible opportunities in the labor market."[148] The built-in affordability of ISA funding alleviates the financial strain students feel and liberates them from the constraints of predatory loan terms.[149] This may enable

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143. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 2.

144. *Id.*

145. DOUG SHAPIRO ET AL., NAT'L STUDENT CLEARINGHOUSE RESEARCH CENTER, COMPLETING COLLEGE: A STATE-LEVEL VIEW OF STUDENT ATTAINMENT RATES 12 (2016), https://nscresearchcenter.org/wp-content/uploads/NSC_Signature_Report_8_StateSupp.pdf.

146. Lou Carlozo, *Why College Students Stop Short of a Degree*, REUTERS (Mar. 27, 2012, 1:18 PM), http://www.reuters.com/article/us-attn-andrea-education-dropouts-idUSBRE82Q0Y120120327 ("That puts the United States behind Japan (89 percent), and former Soviet-bloc states such as Slovakia (63 percent) and Poland (61 percent).").

147. *Id.* ("Many students approach the dropout decision as a simple cost-benefit analysis. They ask themselves whether leaving will put them financially ahead of where they'll be after amassing four years of student loan debt in a lukewarm job market.").

148. WILLIAM C. SYMONDS ET AL., HARV. GRADUATE SCH. OF EDUC., PATHWAYS TO PROSPERITY: MEETING THE CHALLENGE OF PREPARING YOUNG AMERICANS FOR THE 21ST CENTURY 10–11 (2011), https://dash.harvard.edu/bitstream/handle/1/4740480/Pathways_to_Prosperity_Feb2011-1.pdf?sequence=1.

149. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 1–2.

students to attend to familial obligations, which play a significant role in why students drop out of four-year degree programs.[150] Furthermore, ISAs can offer a solution to the additional problem of result-oriented transparency.[151]

Detractors of ISAs may point to adverse selection as a potential problem with the funding vehicle, suggesting that the best students may opt for a traditional loan with the assumption that they will ultimately pay back less than they would with an ISA.[152] Thus, they claim, the ISA pool would be burdened with less ambitious individuals shielding themselves from risk and paying back less than the capital distributed to them.[153] This, however, is mitigated by the fact that each individual is offered a different contract depending on amount borrowed, course of study, and career plans.[154] Furthermore, Palacios has explained that the fear of students being dishonest about their career intentions simply has not taken root.[155]

ISAs can, however, provide students with insight as to which courses of study are most likely to provide them with employment and earning opportunities upon graduation.[156] Students investing in their educations and financial futures would be able to participate in a financing program that would "channel[them] to high-quality, low-cost programs."[157] In the current educational environment, students often choose majors without significant information about the corresponding job prospects of that area.[158] In assessing an ISA contract, students will be provided with information about the value that financiers expect their academic programs to provide, in terms of monetary return.[159] By

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150. *See* Carlozo, *supra* note 146.

151. *See e.g.*, PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 11; *Graduate Stock*, THE ECONOMIST (Aug. 20, 2015), http://www.economist.com/news/finance-and-economics/21661678-funding-students-equity-rather-debt-appealing-it-not.

152. *See* Bachelder, *supra* note 18; PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 11.

153. *See* Bachelder, *supra* note 18.

154. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 11 ("The key feature that reduces the potential for adverse selection is that different students do not face identical contracts. Instead, investors will adjust the terms of ISAs on the basis of different circumstances, most notably in response to differences in the programs students are pursuing.").

155. Bachelder, *supra* note 18 ("The concern that we're going to end up with a bunch of French literature students who said they wanted to be investment bankers hasn't panned out.").

156. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 1.

157. *Id.*

158. *Id.* at 8.

159. *See, e.g.*, *id.* For example,

rewarding the nation's most efficient higher-education programs, the market would react by imitating and competing with these programs, increasing the availability of empirically proven educational investments, and therefore curtailing tuition inflation.[160] Such an effect would provide a positive externality to both students utilizing ISAs and students opting for more traditional financing methods, as market forces drive the exorbitant costs of post-secondary education downward.[161] The value of an institution with high tuition, but meager economic returns for graduates, will be on display for students comparing ISA agreements.[162] In this sense, ISAs truly distinguish themselves from income-based repayment plans put in place to temporarily relieve graduates from traditional loan obligations, since such payment plans fail to offer the market insight as to which educational programs offer the most value.[163] By simply "throwing money at the problem," income-based repayment plans that have been introduced are mere temporary solutions, which do little to address the underlying issues of the higher education market.[164]

VI. WHY HAVE ISAS EXPERIENCED SLOW GROWTH IN POPULARITY?

Given the numerous advantages that ISAs can provide to students and investors alike, whether they participate directly in the funding

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> Think again of prospective student Claire: suppose she can attend Good Institute, where she can finance the tuition for a degree by committing to pay [5%] of her income for [ten] years after graduation, or she can attend Mediocre School, where she can finance the tuition for a similar degree by committing to pay [10%] of her income for ten years. Faced with these options, Claire has a strong incentive to attend Good Institute instead of Mediocre School, even if Good Institute has higher tuition. In addition, there might be a third option, Worthless Program, for which she would not be able to obtain an ISA at all, putting pressure on such programs to improve their quality or go out of business.

Id. at 8.

> The fact that Claire can commit a lower percentage of her income to attend Good Institute, even though its tuition is higher, reveals that Claire can expect higher future earnings with a degree from Good Institute rather than with a degree from Mediocre Institute.

Id. at 17 n.20.

160. *Id.* at 4.

161. *See id.*

162. *Id.* at 8.

163. Bachelder, *supra* note 18 ("In response, the Obama administration has taken the 'throw money at the problem' approach, as Mr. Palacios puts it, by expanding the Pay As You Earn program, under which students can curb their payments if their earnings don't keep up. Those programs 'do not help students make better choices about where to go and what to study[]' . . . .") (citation omitted).

164. *Id.*

programs or not, the slow adoption of these innovative funding vehicles is rather curious.[165] Considering the good that they can provide and the real-life problems they can immediately begin to solve and curtail, why have ISAs failed to take on a larger role in the funding of post-secondary education in America? After all, ISAs programs have proven to be successful mechanisms in other developed countries, such as Chile.[166] Much of the hesitation in the United States to implement a vanguard ISA program for college financing is predicated upon a "Chicken or the Egg" problem.[167]

Signing away rights to a percentage of future earnings is not a decision that students take lightly. Similarly, fronting thousands of dollars to finance a student's education is a significant investment, one in which an investor would pore over past results and data before pulling the trigger.[168] Unfortunately, despite the general success of ISA programs in other countries, the comparisons must be qualified by the fact that the United States endures a different regulatory environment than its foreign counterparts.[169] Thus, students and investors may prefer to examine the track records of others who have engaged in ISAs before committing to ISAs themselves.[170] Unfortunately, the lack of prior data deters the investment of substantial capital.[171] At the same time, the absence of significant capital investment has prevented the creation of a historical record needed to encourage investment in the first place.[172] The cycle is only exacerbated by the murkiness of the regulatory and taxation laws that apply to ISAs.[173]

Currently, ISAs function in a "legal gray zone" where regulators have not yet determined how these instruments should be addressed.[174] To this point, the only legislation proposed to specifically address ISAs was shut down before making it out of the Senate Finance Committee.[175] This lack of legal clarity has contributed greatly to the

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165. *See e.g.*, PALACIOS, DESORRENTO, & KELLY, *supra* note 18, at 1–2; Bachelder, *supra* note 18.
166. Bachelder, *supra* note 18.
167. MARCUS, *supra* note 38, at 4.
168. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 7–8, 11.
169. *See e.g.*, Bachelder, *supra* note 18.
170. MARCUS, *supra* note 38, at 4.
171. *Id.*
172. *Id.* ("[ISAs] do not have enough of a track record to attract significant capital—or enough capital to create a significant track record.").
173. *Id.*
174. Cowley, *supra* note 21.
175. Investing in Student Success Act of 2014, S. 2230, 113th Cong. (2013-2014), https://www.congress.gov/bill/113th-congress/senate-bill/2230/text (stating that the purpose of the act is to "provide the legal framework necessary for the growth of

failure of a significant ISA program development.[176] In order for ISA agreements to become large players in the educational financing arena, the issue of legal uncertainty must be resolved.[177] The Consumer Finance Protection Bureau ("CFPB"), which currently oversees the student loan industry, is monitoring ISA programs, but it has not offered an industry-wide standard for the financing firms offering these vehicles to adhere to.[178] Consequently, firms experimenting with ISAs have attempted to conform their products to current consumer-protection laws, a task akin to fitting a square peg in a round hole.[179]

When confronted with novel and unique financial instruments that operate in a legal gray area, such as ISAs, the natural reaction is to adhere to the regulations in place for analogous, yet distinct financial instruments.[180] In the case of ISAs, the notion of offering equity in an individual or selling stock in oneself directs observers to analogize to securities law.[181] Conversely, and particularly in the educational financing context, where ISAs are used as direct substitutes for traditional loans, the analogy to debt instruments also arises.[182] Since existing ISA programs for educational financing are varied and nuanced, this Note will focus on the regulatory foundation required to advance the growth of an institution-backed ISA program of the same ilk as Purdue University's "Back a Boiler" program.

VII. EXAMINING PURDUE'S BACK A BOILER PROGRAM

The most recent and the most promising ISA program introduced as an alternative mechanism for financing college education is Purdue

innovative private financing options for students to fund postsecondary education, and for other purposes").

176. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 2.

177. *Id.*

178. Cowley, *supra* note 21 ("'It is important that consumers know up front the costs and risks of financial products,' said Seth Frotman, the [CFPB's] student loan ombudsman. 'This generally isn't the case for income-sharing agreements, which can create challenges for borrowers trying to navigate their repayment options.'").

179. *Id.*

180. *See generally* Shu-Yi Oei & Diane Ring, *Human Equity? Regulating the New Income Share Agreements*, 68 VAND. L. REV. 681, 687–688 (2015) (addressing the public policy and legal issues raised by ISAs and articulating an approach to a regulatory scheme).

181. Schwartz, *supra* note 27, at 1121–22.

182. *Id.* at 1137 (asserting that there is a "structural similarity" between ISAs and peonage, a form of servitude by a debtor who must work until his debt is paid off).

University's Back a Boiler program.[183] Upon examining this program more closely, the remainder of this Note will highlight its most noteworthy and beneficial components, and suggest the proliferation of the same model at public and private universities throughout the country. Moreover, this Note will discuss the laws by which an ISA program of this model should be governed, specifically tracing the suitability of federal securities laws. Finally, this Note will identify the most important guidelines of the Back a Boiler program and lay them out as the basis for a nascent regulatory framework of educational ISA programs.

In the spring of 2016, the Purdue Research Foundation at Purdue University rolled out the Back a Boiler-ISA Fund, a program with the tagline: "It's not a loan. And you're not alone."[184] The rationale behind the new funding initiative was to give students another option to pay for school, without taking grants or loans, and the school touts the program as an "opportunity to complete an education without worrying about interest rates."[185] The school aspires to eventually employ the "evergreen" model of self-sufficiency, but the Purdue Research Foundation has provided the initial $5 million investment.[186]

Currently, nearly seventy different majors are represented in the pool of students participating in the program.[187] The school explicitly states that the program is not a loan, but rather an alternative to private loans and public loans such as Parent PLUS.[188] In essence, the

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183. Douglas-Gabriel, *At Purdue*, *supra* note 29 ("Purdue is the first American university to experiment with ISAs in more than 40 years, and if successful, could mainstream a novel alternative to private student loans.").

184. Purdue Research Found., *Back a Boiler™ Program Overview*, PURDUE.EDU, http://purdue.edu/backaboiler/overview/index.html (last visited Mar. 1, 2018) [hereinafter *Back a Boiler Overview*].

185. *Id.*

186. *See* Schneider, *supra* note 28.

187. Schneider, *supra* note 28 ("'It's simply based on a first come, first serve to qualified students. We're not giving any preferences to engineers over the college of education, nor vice versa. We're looking at every student who applies and looking at them for their potential,' [Purdue financial aid chief Ted] Malone said."); Purdue Research Found., *Back a Boiler*, PURDUE.EDU, http://purdue.edu/backaboiler (last visited Mar. 1, 2018) ("Since launching in Purdue's 2016 fall semester, 160 students received Back a Boiler funding totaling about $2.2 million. There are 79 unique academic majors represented in this group. The top six colleges represented are: Engineering, Polytechnic Institute, Health and Human Sciences, Liberal Arts, Krannert School of Management, and Agriculture.").

188. *Back a Boiler Overview*, *supra* note 184. For more information about the burdens of Parent PLUS Loans, see Betsy Mayotte, *4 Things Borrowers Don't Always Know About Parent PLUS Loans*, U.S. NEWS & WORLD REP. (Apr. 27, 2016, 10:00 AM), http://www.usnews.com/education/blogs/student-loan-ranger/2016/04/27/4-things-borrowers-dont-always-know-about-parent-plus-loans (explaining that "[p]arents may be caught off-

Purdue Research Foundation offers funding for students, who in return, agree to pay back a designated percentage of their salary for no more than nine years.[189] The agreement does not, however, confer any rights to the Purdue Research Foundation with regards to the educational and employment decisions of the student.[190] Students participating in the program maintain complete academic and career-based autonomy.[191]

The Back a Boiler-ISA Fund does not require full repayment of the principal, as long as the contract terms are met.[192] The standard ten-year payment period makes the Back a Boiler-ISA Fund "competitive with most federal" and private loan terms, and a six-month grace period is offered after graduation before payments must be made.[193] The Purdue Research Foundation does not want students taking the decision to participate in the ISA program lightly, so it offers comparison tools for students to assess their different funding options.[194] In promoting the Back a Boiler-ISA Fund, however, the literature stresses that the program does not denote academic performance minimums, does not require full repayment, is not a long-term commitment with a principal balance, does not accrue interest, and asserts that the duration of repayment is below average.[195]

Given the absence of interest tied to the ISA, the amount required for repayment will not grow, except with respect to the increase of a

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guard when they start receiving bills for parent PLUS loans," as the loans may be less affordable than they seem, and there are less payment and forgiveness options).

189. *Back a Boiler Overview*, *supra* note 184 ("For example, you're a rising senior Economics major with an ISA of $10,000. Based on your anticipated salary in that field upon graduation, you pay 3.38% of your $47,000 salary for 100 months. At the end of the contract, you would have paid back $15,673, and fulfilled the terms of your ISA. A traditional, private loan of $10,000 at 9.5% fixed interest to a student with no cosigner would cost you $17,126 at the end of a 10-year term.").

190. *Back a Boiler Overview*, *supra* note 184.

191. *See id.*

192. *Id.*

193. *Id.*

194. *Id.* Purdue encourages applicants to generate differing scenarios and agreement terms using their comparison tool. *See* Purdue Research Found., *Back a Boiler Comparison Tool*, PURDUE.EDU, http://purdue.edu/backaboiler/comparison/index.html (last visited Mar. 1, 2018).

195. *Back a Boiler Overview*, *supra* note 184; Purdue Research Found., *Back a Boiler Overview*, PURDUE.EDU, https://www.purdue.edu/backaboiler/overview/BackABoiler_Overview_v17.7.pdf (last visited Mar. 1, 2018); Allie Bidwell, *Student Loan Expectations: Myth vs. Reality*, U.S. NEWS & WORLD REP. (Oct. 7, 2014, 12:01 AM), http://www.usnews.com/news/blogs/data-mine/2014/10/07/student-loan-expectations-myth-vs-reality ("The standard repayment plan for federal student loans puts borrowers on a 10-year track to pay off their debt, but research has shown the average bachelor's degree holder takes 21 years to pay off his or her loans. Under federal income-based repayment options, remaining debt is forgiven after 20 years.").

graduate's income.[196] The contractual share of income remains the same throughout the repayment period.[197] The major risk that students face when participating in the Back a Boiler program is that they may earn more income than projected when developing the specific ISA contract, and hence, will end up paying back more than they would have under traditional loan agreements.[198] However, the system incorporates safeguards to prevent exorbitant repayments in the case of graduates earning unusually high incomes by setting a cap on the total amount paid.[199] Additionally, the program helps limit the risk involved with personal and academic decisions after graduation.[200] For example, students who choose to attend graduate school will have their ISA paused for up to five years.[201] This places the graduates in non-payment status until they complete their graduate program, and then the ISA term is prolonged by the duration of the hiatus.[202] Similarly, students who leave the workforce to travel or have children have their ISA agreements tolled until they re-enter the workforce or a five-year span elapses, at which point they would continue making payments in proportion to their income.[203] However, if students are unemployed, they are not required to make monthly payments while seeking employment, nor is the payment term extended.[204] Additionally, students who fail to meet a minimum income threshold are eligible for deferment.[205] Graduates who earn less than $1,666.67 monthly, which is an annual salary of less than $20,000, qualify for deferment and do not have to make payments.[206] Those who fall below the income threshold while working part-time will receive an expanded payment term to compensate for the months of deferred non-payment, while

196. Purdue Research Found., *FAQ about Back a Boiler-ISA Fund*, PURDUE.EDU, http://purdue.edu/backaboiler/FAQ/index.html (last visited Mar. 1, 2018) [hereinafter *Back a Boiler FAQ*].

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.* Similarly, a student who transfers schools will also have his ISA tolled until graduation. *Id.*

203. Purdue Research Found., *Back a Boiler ISA Sample Contract*, PURDUE.EDU, http://purdue.edu/backaboiler/disclosure/contract.html (last visited Mar. 1, 2018) [hereinafter *Back a Boiler Sample Contract*] (noting that additional deferment scenarios arise when a borrower can show that they (i) have enrolled at least half-time "in Higher Education or Training," (ii) are employed full- or part-time and earn less than $1,666.67/month (equivalent to $20,000/year), (iii) are unemployed, or (iv) are "[n]ot in the labor force").

204. *Id.*

205. *Id.*

206. *Id.*

those whose full-time salary fails to meet the $20,000 mark are simply not required to make payments or extend the payment term.[207]

The Back a Boiler application and sample agreement addresses repayment details more specifically.[208] The range of duration and repayment terms for every $1,000 of funding spans from .173% to 0.497% of total income for 80 to 116 months.[209] The total funding amount granted ranges from $5,000 to $33,000.[210] Each individual's ISA contract is based on funding amount and projected income, a figure determined by a combination of degree level, year of school, and major, among other factors.[211] Regardless of income level, the maximum repayment is capped at two and a half times the initial amount borrowed.[212] Additionally, to qualify for the Back a Boiler program, a student must not have combined ISA obligations to Purdue University or any other entity or individual that amount to greater than 15% of total income.[213] This protective measure presumably helps to ensure that graduates do not unwittingly strain themselves with excessive obligations from various funding agencies upon graduation.

In calculating monthly payments, the Back a Boiler program requests paystubs or letters from employers to verify monthly earned income.[214] The program's contracts define "earned income" as "total wage and self-employment income."[215] This number is determined by taking the sum of Line 7 and Line 12 on the IRS form 1040 or using Line 1 on the IRS form 1040EZ.[216] Each year, income share borrowers must provide Back a Boiler and the Purdue Research Foundation with

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207. *Id.* "Part-time employment" is defined as working less than thirty-five hours per week, while full time employment is defined as working thirty-five hours or more per week, at one or more jobs. *Id.*

208. *Purdue Research Foundation: Back a Boiler Application and Solicitation Disclosure*, PURDUE.EDU, http://purdue.edu/backaboiler/disclosure/application.html (last visited Mar. 1, 2018) [hereinafter *Back a Boiler Application*].

209. *Id.*

210. *Id.* The cost of Purdue University's tuition, fees, and room and board total $20,022 for Indiana residents and $38,824 for non-Indiana residents for the 2016-2017 school year. *Undergraduate Admissions: Tuition and Fees*, PURDUE.EDU, https://www.admissions.purdue.edu/costsandfinaid/tuitionfees.php (last visited Mar. 1, 2018).

211. *Back a Boiler Application, supra* note 208.

212. *Id.*

213. *Id.* ("Your total obligations under all income-based agreements with us or another person must not require you to pay an aggregate income share exceeding [15%] of your earned income . . . .").

214. *Id.*; *Back a Boiler Sample Contract,* supra note 203.

215. *Back a Boiler Sample Contract, supra* note 203.

216. *Id.* In cases where taxes are filed jointly with a spouse, "'[e]arned income' includes all income reported on a joint income tax return, *minus*, to the extent documented to our satisfaction, any income earned solely by your spouse." *Id.*

salary documentation before April 30, so the program can calculate the new payment amounts by June 1.[217] Failure to provide the program with updated annual pay documentation results in the presumption that the graduate's income has increased by 10%, and scheduled payments are calculated accordingly.[218] This annual adjustment process may result in occasional under- or over-payments throughout the year, should an individual experience a shift in income between annual reporting periods.[219] To account for such fluctuations, the foundation requests tax return information from the IRS to use for crediting overpayments and receiving reimbursements for underpayments.[220]

VIII. SHOULD SECURITIES LAWS APPLY TO ISAS?

Examining the regulation of the Back a Boiler ISA program more closely, it is important to define whether securities laws apply, and therefore, what exactly constitutes a security. In the context of regulation in financial markets, "securities" are defined in both the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934.[221] Notably, the Securities Act of 1933 outlines the term "security" as "any note, stock, treasury stock, . . . bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate," as well as a catchall term of "investment contract."[222] Since the ISA program represents a new category of investment vehicle that does not fit into the initially enumerated categories of the Securities Act definition, we must look to the comprehensive term "investment contract" for further analysis.[223]

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217. *Back a Boiler Application*, *supra* note 208.

218. *Id.*

219. *See id.*

220. *See Back a Boiler Sample Contract*, *supra* note 203 ("On or before April 30 each year of the Payment Term and April 30 following the end of the Payment Term, you agree to provide us with: (i) A completed and signed IRS Form 4506T . . . designating us as the recipient of your tax return information for returns covering any and all months of your Payment Term, dated not earlier than thirty (30) days before the date you provide it to us; and one of the following to verify your Earned Income or deferment status for the preceding year: (ii) A year-end pay stub, Form W-2, Form 1099, Schedule K-1, or other verifiable source . . . for each source of Earned Income in the prior calendar year . . . .").

221. *See* 15 U.S.C. § 77b(a)(1) (2012); 15 U.S.C. § 78c(a)(10) (2012).

222. 15 U.S.C. § 77b(a)(1) (2016).

223. *See* Schwartz, *supra* note 27, at 1157 ("The legal definition [of "security"] . . . also includes so-called investment contracts within its reach. This vague reference has evolved into a heavily-litigated catch-all that could potentially encompass the unique type of instrument at issue here.").

The scope of the term "investment contract" was addressed in the Supreme Court case *SEC v. W.J. Howey Co.*[224] The Court's decision broke down the definition into four elements: "[1] a person invests his money [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or a third party."[225] The ISA business models and experiments outlined earlier in this Note generally satisfy the first prong of the "investment contract" definition. There is a clear and voluntary investment of money, satisfying the first element of the *Howey* test.[226]

In assessing the "common enterprise" requirement, a handful of commonalities may be accepted.[227] Different circuit courts have recognized different types of commonalities as acceptable, and to this point uncertainty still exists about which type of commonality satisfies the *Howey* test.[228] Horizontal commonality requires investors pooling their assets and sharing in the risk and rewards of an enterprise.[229] Given the pooling of investor funds in the Back a Boiler program, the "common enterprise" element is satisfied.[230] However, other courts require broad vertical commonality, in which the success of investors depends upon the promoter's expertise.[231] With the Back a Boiler program and other potential programs of similar design, the students' expertise may not be the only factor contributing to the success of the venture. Because the funding comes from a school-affiliated entity, the post-graduate success of the students is indeed tied to the ability of the "investor"—ultimately Purdue University—to adequately prepare

224. SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946); *see also* Schwartz, *supra* note 27, at 1158; STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 102 (Robert C. Clark et al. eds., 3d. ed. 2012).

225. CHOI & PRITCHARD, *supra* note 224, at 104; Schwartz, *supra* note 27, at 1158 (citing *Howey*, 328 U.S. at 298–99 ("[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.")).

226. *See* Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559 (1979) (emphasizing the notion of choice by declining to label a noncontributory, compulsory pension plan an investment contract).

227. SEC v. SG Ltd., 265 F.3d 42, 49–50 (1st Cir. 2001).

228. *Id.*

229. *Id.* at 49.

230. *See* Schwartz, *supra* note 27, at 1158 ("To satisfy [the common enterprise] requirement, courts generally look to see whether there is 'horizontal commonality.' This is present when investors pool their money to back the enterprise in question. The idea is that there is a collection of investors whose stakes are tied together.").

231. *SG Ltd.*, 265 F.3d at 49.

students for employment and connect them with opportunities. In more interpersonal models of ISAs, the investor may offer personal guidance, counseling, and even job opportunities to student borrowers, which deviates from the broad vertical commonality required by two of the circuit courts.[232] This scenario in which investor success is "interwoven with and dependent upon" the efforts of students aligns more closely with the narrow vertical commonality adhered to by the Ninth Circuit.[233] While ISA programs like Back a Boiler generally achieve horizontal commonality, the lack of a clear federal standard makes the satisfaction of the second *Howey* element a bit murky.[234]

The third and the fourth factors of the "investment contract" definition are where the categorization of ISAs gets more muddled. While some contributors to ISA investment pools may seek a purely financial return, other ISA programs are set up with more philanthropic intentions.[235] Publicly funded programs like Oregon's "Pay It Forward" platform, Purdue's Back a Boiler, and other ISA programs operating on similar "evergreen" models are designed in such a way as to create a cyclical self-funding mechanism wherein returns are reinvested into the next class of students, rather than cashed out by investors.[236] This lack of profit motive may indicate that ISAs do not align completely with the definition of "investment contracts."[237] If payments from borrowers are funneled back into the general financing pool, then the capital appreciation or participation in earnings may not be the driving force of the investor—or perhaps "donor" would be a better term.[238] While there have been rulings that semi-charitable investments are still considered investment contracts, those holdings have focused on the "opportunity for financial gain" and the fact that marketing and advertising materials were designed to attract

232. *See id.*

233. *See id.* at 49–50 (citing SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 n.7 (9th Cir.1973)).

234. *See id.*

235. *See* discussion *supra* Section II.F.

236. *See* MARCUS, *supra* note 38, at 8.

237. *See* Schwartz, *supra* note 27, at 1161 ("In sum, equity shares in people as currently offered by for-profit ventures . . . fall rather neatly within *Howey's* delineation of investment contracts. Equity-sharing platforms with a philanthropic structure, however, may fall outside of this legal construct . . . .").

238. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975) ("By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . .").

individuals seeking profits and tax benefits.[239] Hence, part of the satisfaction of the third prong of the investment contract test depends on how the ISA program promotes itself.[240] In the case of the Back a Boiler program, all of the promotional literature is directed at students as opposed to funding contributors, suggesting that perhaps the program does not satisfy the third *Howey* prong.[241]

Finally, the fourth *Howey* factor, the sole reliance on efforts of others, also prompts further debate regarding educational ISAs like Back a Boiler. One of the flexibilities and potential benefits of ISA agreements is the potential for the investing parties to assist the students accepting funding.[242] This may take many forms, including advising, career counseling, and networking, and can contribute to the investment's success.[243] If the Purdue Research Foundation is contributing to the success of student participants by providing professional seminars, counseling services, and employment-seeking resources, then it is, arguably, not relying solely upon the efforts of students.[244] If the ISA is viewed as a partnership between the funding provider and the student recipients, analogies can be drawn to past court rulings where the degree of control is weighed to determine if the partnership qualifies as an investment contract.[245] The *Williamson v. Tucker* decision identifies situations where one partner's control over a venture is sufficiently limited so as to satisfy the fourth prong of the *Howey* test, such as a situation where one partner is so dependent on the entrepreneurial ability of the enterprise manager that he cannot replace him.[246] The power balance of control favors the students in the

239. *See, e.g.*, Warfield v. Alaniz, 569 F.3d 1015, 1022–25 (9th Cir. 2009) ("In sum, when the promotional materials are examined, the investment component of the annuity is evident.").

240. *See id.*

241. *See generally Back a Boiler Overview*, *supra* note 184.

242. *See, e.g.*, *id.*

243. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 1–2.

244. *See* Schwartz, *supra* note 27, at 1161. The court does temper this element, holding that "meaningful control" is the standard. *Id.* However, an argument can certainly be made that providing resources that directly affect the employment prospects and economic success of a student recipient is "meaningful[ly] control[ling]" one's investment. *See id.*

245. SEC v. Merch. Capital, LLC, 483 F.3d 747, 755 (11th Cir. 2007) (citing Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1981)) (stating that as long as one *Williamson* factor is satisfied, the agreement is an investment contract).

246. *Id.* (quoting *Tucker*, 645 F.2d at 424) ("*Williamson* recognized three situations where [a partner retains little ability to control the profitability of the investment]: (1) '[A]n agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership,' (2) '[T]he partner or venturer is so inexperienced and unknowledgeable in business affairs

case of ISAs, but analogizing this type of arrangement to a general partnership is also not completely cogent.

The difficulty involved in conforming educational ISA programs to the definition of "securities" suggests that a distinct regulatory scheme is required outside of the traditional securities laws. In fact, in *International Brotherhood of Teamsters v. Daniel*, a contributing factor to the court's holding that a pension fund was not a security was the existence of the Employee Retirement Income Security Act of 1974 ("ERISA"), which was enacted to handle exactly the type of plan being addressed in the case.[247] ERISA was directly cited by the court as a reason not to enforce securities regulations, and it rendered the Securities Acts as "serv[ing] no general purpose."[248] The passage of ERISA was to "fill[] a regulatory void," and the Securities and Exchange Commission ("SEC") supported the legislation.[249] Alternative regulatory schemes are put in place because there is a need to protect investors in a "more definite form,"[250] and the ISA arena is an environment that could certainly use more specific guidelines.

Furthermore, the purpose of securities laws "is to protect investors."[251] With traditional securities, investors may suffer an informational disadvantage that may leave them susceptible to fraudulent practices on the part of corporations.[252] As such, common sense would dictate that corporations are generally privy to an informational advantage, and therefore, in a position of power. However, in the case of educational ISA programs, the "investors" are the individuals or organizations offering funding for college tuition that the recipients desperately need.[253] Hence, the power structure is

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that he is incapable of intelligently exercising his partnership or venture powers,'; or (3) '[T]he partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.' Under *Williamson*, the presence of any one of these factors renders a general partnership interest an investment contract.") (citations omitted).

247. Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 569–70 (1979); *see generally* Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829.

248. *Daniel*, 439 U.S. at 570 ("Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA.").

249. *Id.*

250. *Id.*

251. *See What We Do*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/about/whatwedo.shtml (last visited Mar. 1, 2018) (providing an overview of the various securities laws enforced by the commission).

252. *See id.*

253. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 1 ("With an ISA, an investor or other organization provides a student with financing for higher education in

reversed from the conventional securities scenario. It is important that the law protect not only the investors, but also the students receiving funds. Securities laws are not designed to protect the corporations into which investors put their money, and by analogy, are not designed to protect the students who use ISAs. Accordingly, securities laws are insufficient to regulate this new investment vehicle.

IX. INSPIRATION FOR AN ALTERNATIVE REGULATORY FRAMEWORK

Clearly, legislation needs to catch up to the innovation of new financing mechanisms, but what exactly should this new regulation of ISAs include? To establish a proper regulatory framework that protects investors and students alike and allows for the large-scale integration of these financing vehicles, we must evaluate past legislative proposals and the terms and conditions of small-scale ISA programs currently in operation, namely Back a Boiler.

United States Senator Marco Rubio (R-FL) has been outspoken about his struggle with student debt and introduced in the spring of 2014, along with Wisconsin congressman Tom Petri, legislation to address treatment of ISAs.[254] The bill, coined the Investing in Student Success Act, aimed to provide legal guidelines for ISAs, encourage investor participation, and promote the use of ISAs as an alternative to traditional loans.[255] While the Rubio-Petri bill did not make it out of committee,[256] Rubio's commitment to introducing a small, private ISA market that coexists with current student loan agreements has

exchange for a percentage of the student's future income for a defined period of time after the student finishes school.").

254. *Rubio, Petri Legislation Would Give Students Access to Innovative College Financing Option*, MARCO RUBIO U.S. SEN. FOR FLA. (Apr. 9, 2014), https://www.rubio.senate.gov/public/index.cfm/press-releases?ID=587240D7-BFBF-4EAF-B6E3-346195C70622.

255. *Id.*; Investing in Student Success Act of 2014, S. 2230, 113th Cong. (2013–2014), https://www.congress.gov/bill/113th-congress/senate-bill/2230/text; Caren Bohan & Julia Edwards, *Republican Rubio Offers New Bill on New Education Financing Vehicles*, REUTERS (Apr. 9, 2014, 5:38 PM), http://www.reuters.com/article/us-usa-congress-rubio-education-idUSBREA380BJ20140409 (noting that Rubio said "'Many players have resisted getting into the marketplace because they're not sure of the legal certainty behind it. The fact that it's now a recognized investment vehicle would allow more players to get into the space and could encourage more to come forward.'"). Rep. Petri proposed a companion bill in the House of Representatives. Investing in Student Success Act of 2014, H.R. 4436, 113th Cong. (2013–2014), https://www.congress.gov/bill/113th-congress/house-bill/4436/text.

256. Cowley, *supra* note 21.

precipitated a larger public awareness of the instruments.[257] While ISAs need not be limited exclusively to the private market, and programs like Back a Boiler should be encouraged,[258] the proposed Investing in Student Success Act of 2014 offered a framework for the legal implementation of ISAs, [259] much of which should be imitated in future legislative proposals.

The Investing in Student Success Act of 2014 provided definitions and guidelines to protect the interests of both students and investors and clarify the scope of agreements.[260] The Bill first defines "income share agreement" and then requires that each agreement clearly adhere to specific, enumerated qualifications.[261] The Bill then lays out conditions for the terms of ISA contracts, requiring the exemption of at least the first $10,000 of income each year, adjusted annually for inflation, when calculating the repayment obligation.[262] This provision exempts low-income ISA borrowers from payment obligations.[263] The Bill also requires that the ISA contract must explicitly define how income will be measured,[264] and then sets a cap of 15% on the income sharing obligation.[265] Additionally, the Bill lays out a maximum repayment period of thirty years, and requires that the terms for extension of the period may be extended one year for every year that an individual's income is below the exemption threshold of $10,000.[266] Finally, the ISA must explicitly specify the process for early termination of the agreement.[267]

The Rubio-Petri Bill also requires several disclosures in addition to the agreement terms, specifically disclosure that the agreement is not a

257. Derek Johnson, *With Jeb Bush's Exit, Proponents of Income Share Agreements Look for Other Options*, GOODCALL (Feb. 26, 2016, 3:33 PM) https://www.goodcall.com/news/with-jeb-bushs-exit-proponents-of-income-share-agreements-look-for-other-options-04897. Jeb Bush, in his presidential campaign, advocated for a federally run ISA program in which students pay 1% of their income for 25 years, for every $10,000 borrowed. *Id.*

258. *See, e.g.*, Schneider, *supra* note 28.

259. Investing in Student Success Act of 2014, S. 2230, 113th Cong. (2013-2014), https://www.congress.gov/bill/113thcongress/senate-bill/2230/text.

260. *See id.*

261. *Id.* § 102(a) ("For purposes of this title, the term 'income share agreement' means an agreement between an individual and any other person under which the individual commits to pay a specified percentage of the individual's future income, for a specified period of time, in exchange for payments to or on behalf of such individual for postsecondary education, workforce development, or other purposes.").

262. *Id.* § 102(b)(1).

263. *See id.* § 102(b).

264. *Id.* § 102(b)(2).

265. *Id.* § 102(b)(3).

266. *Id.* § 102(b)(4).

267. *Id.* § 102(b)(5).

debt instrument, that students may be required to pay more or less than the amount received, and that obligations under the agreement are not dischargeable in bankruptcy.[268] It also contains a noninterference provision that states an ISA does not confer any rights to the holder of the agreement over a student's actions.[269] Additionally, the Bill exempts ISAs from state usury laws,[270] and addresses tax code treatment.[271] ISA payments are to be excluded from gross income[272] and to be considered "qualified educational loans" for the purposes of the Internal Revenue Code of 1986, but not eligible for an allowance deduction.[273]

The following year, Rubio introduced a new iteration of the Investing in Student Success Act.[274] The amended proposal contained much of the same verbiage, but bumped the minimum income threshold up to $15,000.[275] Indiana Representative Todd Young and Colorado Representative Jared Polis introduced a bi-partisan companion bill in the House of Representatives in 2015 which closely mirrored Rubio's, but required a minimum income of $18,000.[276] Additionally, Rubio's second attempt introduced a metric defined as a "commitment factor," used to ensure that a student is not overly encumbered with ISA obligations.[277] The commitment factor is simply the percentage of income required under the agreement multiplied by the remaining years in the agreement.[278] The Bill sets a maximum commitment factor of 2.25, which equates to thirty years remaining in an agreement that requires 7.5% of income to be repaid.[279]

268. *Id.* § 102(c).
269. *Id.* § 102(d).
270. *Id.* § 104.
271. *See id.* § 201.
272. *See id.* § 201.
273. *Id.* § 301(a) ("Paragraph (1) of section 221(d) of the Internal Revenue Code of 1986 is amended by adding at the end the following: 'Such term includes any income share agreement (as defined in section 102 of the Investing in Student Success Act of 2014), except that payments made by the taxpayer during the taxable year to meet an income share agreement obligation shall not be taken into account under subsection (a).'").
274. *See* Investing in Student Success Act of 2015, S. 2186, 114th Cong. (2015-2016).
275. *See id.* § 102(b)(1).
276. Allie Bidwell, *Congressmen Introduce Bipartisan Income-Share Agreements Bill*, NAT'L ASS'N STUDENT FIN. AID ADMINISTRATORS (July 30, 2015), https://www.nasfaa.org/news-item/5226/Congressmen_Introduce_Bipartisan_Income-Share_Agreements_Bill; Investing in Student Success Act of 2015, H.R. 3432, 114th Cong. (2015-2016), https://www.congress.gov/bill/114th-congress/house-bill/3432/text.
277. S. 2186 at § 102(b)(5)(B).
278. *Id.* at § 102(b)(5)(B)(i)-(ii).
279. *Id.* at § 102(b)(5)(C).

Furthermore, the 2015 version of the Bill requires additional disclosure.[280] It states that ISA contracts must include comparisons of the payments required under a range of income levels, and which income levels a student should expect to make considering his use of the funds provided.[281] In other words, the agreement must disclose the expected income levels that correspond with an individual's chosen course of study, so both parties have a clear understanding of risks and expectations.[282] Moreover, the Bill requires the agreement to provide a comparison of projected ISA payments to a projection of payments under a traditional loan agreement with a 10% fixed annual interest rate.[283] The proposal clearly aspires to educate ISA participants about the potential outcomes of such agreements as much as possible before they make a significant commitment of money and time.[284]

Not surprisingly, legislative efforts in the Senate and the House of Representatives share similar concepts with the terms imposed by the Purdue Research Foundation in formulating their Back a Boiler ISA fund.[285] Only now in its first year of practice, the Back a Boiler fund will provide an interesting case study of ISA agreements as time goes on. While proposed bills to this point have failed to become law, a shifting political climate leaves the door open for a legislative effort to pass.[286] Eventual ISA legislation should be sure to draw from the previous proposals as well as the guidelines generated by the Back a Boiler program. While contracts will inevitably vary, it is important that all ISAs adhere to general guidelines. The ultimate regulatory framework should incorporate such familiar definitions as payment caps, percentage caps, minimum income thresholds, and maximum period lengths in the same general range as those proposed by Purdue University and the Investing in Student Success Acts. Furthermore, it should also clearly define the rights of each party to the agreement, lay out early termination terms, and disclose tax and bankruptcy treatment. Finally, and perhaps most importantly, the regulations should expressly outline a comprehensive disclosure policy that allows

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280. *Id.* § 102(c).
281. *Id.* § 102(c)(2)(A).
282. *See id.*
283. *Id.* § 102(c)(2)(B).
284. *See id.* § 102(c)(2).
285. *Compare* S. 2186 at § 102(b)(4) (imposing an obligation limitation of fifteen percent of students' future income), *with Back a Boiler FAQ, supra* note 196 (noting that the Purdue Research Foundation impose an obligation limitation of fifteen percent of the student's future income).
286. Benjamin Wermund, *Republicans Push to Regulate Income-Share Agreements*, POLITICO (June 30, 2017, 10:00 AM), http://www.politico.com/tipsheets/morning-education/2017/06/30/republicans-push-to-regulate-income-share-agreements-221129.

students to fully comprehend the consequences and possibilities of entering into ISAs rather than traditional loan agreements, granting consideration to their proposed course of study and career plans.

One remaining issue that proponents of ISAs point to when discussing the need for regulations in the ISA arena is the collection of data.[287] Information asymmetry necessitates the existence of securities regulations, and similarly, presents a potential problem with ISAs, necessitating the disclosure of educational outcome data.[288] Markets function effectively when sufficient and reliable data is present, and this concept applies to the ISA market as well.[289]

Currently, however, there is a deficiency of data available to evaluate the financial outcomes of various university programs, and consequently assess the value of each program.[290] The reason for this dearth of data is the Higher Education Act, which was reauthorized in 2008 and prevents the government from creating a "federal, student-level database that could link postsecondary and wage information."[291] In fact, the lack of student outcome data at universities is one of the most pressing problems with higher education.[292] This informational blind spot leaves students uninformed when making decisions about their educations and how to finance them, and it also leaves institutions without the proper means to evaluate their own performance and make adjustments accordingly.[293] In order for ISAs to provide the positive externality of bearing out value judgments for postsecondary programs, and hence, activating market forces to reduce tuitions, this data must be made available.[294]

287. *See* PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 2.

288. *See* Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Speech at SEC Open Meeting: Addressing the Information Asymmetry in the Securitization Market to Put Investors and the Economy on Safer Footing (Apr. 7, 2010) (transcript available at https://www.sec.gov/news/speech/2010/spch040710laa.htm).

289. PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 2.

290. *Id.*

291. Palacios & Kelly, *supra* note 8; *see also Congress Should Lift the Ban on Student Level Data in HEA Reauthorization*, ASSOC. OF PUB. & LAND-GRANT U., http://www.aplu.org/policy-and-advocacy/higher-education-policy-student-aid/Higher-Education-Data-policy-brief.pdf (last visited Mar. 1, 2018) [hereinafter *Congress Should Lift the Ban*] ("An amendment to ban a federal unit record system was added to the Higher Education Opportunity Act of 2008."); Higher Education Opportunity Act of 2008, Pub. L. No. 110–315, 79 Stat. 1219 (1965) (codified as amended at 20 U.S.C. § 1002 (2012)).

292. *Congress Should Lift the Ban*, *supra* note 291, at 1.

293. *Id.* Advocates of the ban cite privacy concerns and the potential for federal overreach, but fail to recognize that alternative safeguards may be used instead of denying students and families transparency. *Id.* at 1–2.

294. *See* Palacios & Kelly, *supra* note 8; PALACIOS, DESORRENTO & KELLY, *supra* note 18, at 16 ("Policymakers should start by repealing the federal ban on the collection of

X. CONCLUSION

Combining the approaches of the proposed Investing in Student Success Acts and the Back a Boiler contract terms, along with thwarting the Higher Education Act's ban on data transparency, an effective ISA legal framework can be established that can alleviate investor fears and promote the usage of ISAs for educational financing. More importantly, by proxy, regulatory guidelines would provide students and families with information to better assess educational and funding opportunities, and ultimately provide them with an additional option for surmounting the burdensome hurdle of rising tuition costs. Furthermore, the proliferation of ISAs can actually alert both students and institutions to high-value programs.[295] As a result, ISA providers will offer the most favorable ISA contracts for reasonably priced programs that produce successful employment outcomes, and institutions will be forced to tailor their programs towards increasing value to remain competitive.

An alternative regulatory framework is the missing piece of the puzzle needed to complete the realization of ISAs as legitimate options for the nation's prospective students and families. The more options students have, the better equipped they are to prevent themselves from digging further into the morass of student debt. While ISAs alone are not the panacea to the ever-deepening hole of student debt, they can become a valuable rung on the ladder out of it, and the sooner regulatory legislation is passed, the sooner students and families can receive the assistance they deserve.

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student unit record data and considering policy proposals that call for the collection and dissemination of such data (for example, the Student Right to Know Before You Go Act introduced by Senators Ron Wyden (D-OR) and Marco Rubio (R-FL)).").

295. Palacios & Kelly, *supra* note 8.