

ISA ALLIANCE ▶▶▶

California Department of Financial Protection and Innovation
Emailed to regulations@dfpi.ca.gov
CC: Charles Carriere, charles.carriere@dfpi.ca.gov
RE: “PRO 01-21”

Dear Acting Commissioner Shultz:

Introduction

The Invest in Student Advancement Alliance (ISA Alliance) is a membership organization made up of income share agreement (ISA) stakeholders representing the full continuum of the ISA community from financiers and platforms, to education providers and servicers. The ISA Alliance represents a significant portion of current educational ISA originations. Together, we believe in the substantial positive potential of ISA adoption and application to improve education alignment with student outcomes, equitable access, and improved affordability for education, workforce training, credentialing, and marketable upskilling. The ISA Alliance and its members are dedicated to the promotion of effective and responsible ISA regulations which will allow for a vibrant and accountable ISA market.

ISAs are a non-credit financial instrument which, in consideration for education and training students make a promise for income-contingent, fixed percentage and number of monthly payments. ISA Alliance members utilize these agreements to provide access to education and training opportunities and affordable tuition payment options to students and learners in traditional higher education, certificate programs, workforce training, and bootcamp credential providers.

On September 25, 2020, Governor Newsom signed AB 1864 (Chapter 157, Statutes of 2020), establishing the California Consumer Financial Protection Law (“CCFPL”) under Division 24 of the Financial Code. Under the law, CDFPI is authorized to, "prescribe rules regarding registration requirements applicable to a covered person engaged in the business of offering or providing a consumer financial product or service."¹

The ISA Alliance believes that ISAs are most certainly a financial product, but not credit, and should be treated as a new class of financial instrument. Legal analysis from several law firms bolsters this position.²

¹ https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB1864

² Earley, Maria B., and Robert E. Goldenberg. 2019. “Income Share Agreements: How They Work and Their Place in the Federal Regulatory Regime.” Reed Smith. September. <https://www.reedsmith.com/en/perspectives/2019/09/income-share-agreements-how-they-work-and-their-place>.

The ISA Alliance encourages CDFPI to promulgate new disclosures and safeguards well-tailored to the specific characteristics of income conditional payments and total obligations. The unique functional aspects of ISAs as an income-contingent obligation are detailed below.

The following argues for thoughtful and effective regulation of the ISA market. First, ISAs should not be considered credit. Second, in the event jurisdiction over ISAs is interpreted or expressly granted, CDFPI will serve students best by designing regulations specifically for ISAs.³ Narrowly tailored regulation can ensure these innovative tuition payment tools will continue to provide in-demand alternatives for marketable education and training.

Background

With an ISA, a student receives education and training in exchange for a promise to pay a known, fixed percentage of his or her future income for a fixed number of payments. ISAs come with unique protections for a student's downside risk, including *minimum income thresholds* (also referred to as an *income base*), under which a former student owes nothing unless his or her income exceeds the threshold. The ISA expires and there is no additional obligation when a student's payments are less than the original amount credited after the contractual number of payments or the window of the contract is exhausted.

ISAs shift the risk of an uncertain future away from students onto schools. In contrast to loans, an ISA obligation does not guarantee any payment to the owner of the ISA. ISA obligations can end in one of three ways: (1) a student makes the maximum number of payments, (2) the student excels and reached the predetermined payment cap, or (3) the total deferment period is reached (calendar-based limit). *These are fundamental safeguards in ISAs that do not exist for loans.⁴ If these built-in protections fail to protect the student, ISAs are likely dischargeable in bankruptcy.⁵*

ISAs are contingent obligations. No payments are due unless the student earns a wage exceeding a predetermined minimum income threshold. ISAs have neither principal nor interest and are based on a set percentage of income (the *income share*) for a fixed number of payments. When a student earns below the threshold, no payment is obligated. Earning over the threshold, a student's payment will always be proportional to earnings because the obligation is a fixed

Morrison Foerster. 2019. "Regulatory Treatment of Educational ISAs Under Federal and Select State Consumer Credit Statutes." March. <https://www.mofo.com/resources/insights/190408-regulatory-educational-consumer-credit-statutes.html>

Gardenswartz, Alissa and Arias, Tony. 2020. "Distinct Income Share Oversight Could Reform Student Debt." <https://www.bhfs.com/Templates/media/files/insights/Law360%20-%20Distinct%20Income%20Share%20Oversight%20Could%20Reform%20Student%20Debt.pdf>

³ Pollack, Ethan. 2020. "[Can Student-Centered Income Share Agreements Improve Economic Opportunity and Equity?](#)" The Aspen Institute: Future of Work Initiative. November.

⁴ Earley and Goldenberg. 2019. Discussing the "built-in" protections ISAs have that reduce student exposure by design, "Time-based limitations, in conjunction with the payment cap and income based payment structure, creates a three-pronged structure that limits a student's exposure in the amount it will pay to a Provider. This arrangement simultaneously provides students downside protection in the case of a loss of employment, reduction in salary, and the various hazards associated with federal student loans, such as capitalization of unpaid interest following forbearance periods or negative amortization when making income-driven payments."

⁵ Yet another protection students with ISAs have which is not available with a Qualified Education Loan.

percentage of income to ensure affordability. Educational ISAs set maximum payment caps to limit the total amount that may be obligated in an ISA, and caps are ubiquitous in the educational ISA market today. If a student makes so much that they reach the cap through regular payments the ISA obligation is satisfied.

We assert that ISAs are not credit. This is not a claim that ISAs and ISA providers should not be regulated. We simply believe that ISAs have unique characteristics that are meaningfully different than loans and should be thoughtfully regulated as a different asset class.⁶ The consumer protections promulgated over a long experience with traditional debt has allowed the laws and regulations to tailor themselves to uniquely protect against unconscionably high interest rates and negative amortization which are great risks in traditional credit. While some aspects of traditional lending are substantially similar to ISA characteristics,⁷ the Alliance holds that there are significant and meaningful differences in how ISAs function that justify unique considerations in regulation and disclosure requirements – not less, different.⁸

Application of traditional credit and debt laws without ISA-specific modifications would cause absurd results for the policy goals of transparency and oversight.

ISAs are a tuition financing tool with an income-contingent payment and total obligation. The amount covered by an ISA may inform the income share and term of the contract but does not determine the future obligation. Only future income – when earned and above the minimum income threshold – gives rise to an ISA payment obligation. The risk of poor earnings outcomes of students is carried by the school. This shift of the risk of nonpayment away from the student and onto the school is critical in the legal analysis of whether or not a financial product is a loan for the purposes of the Truth in Lending Act (TILA), nor the Equal Credit Opportunity Act (ECOA) due to the lack of an unconditional obligation to pay a definitive amount.⁹ A similar analysis was applied to the Fair Credit Reporting Act (FCRA).¹⁰ To our knowledge, the courts have yet to consider ISAs specifically.

ISA characteristics that are unlike loans:

- ISAs have no fixed obligation amount (no principal), and the amount paid is based on future income, not the amount financed or how much time has passed. Unlike a mortgage or a loan, the total amount paid, and amount of any payment is contingent on income.
 - With neither principal nor interest, ISAs cannot compute implied APR at origination.
- ISAs are contingent obligations. No payments are due unless the student’s income is above the threshold. This threshold is a student protection that is implemented to ensure

⁶ Pollack. 2020.

⁷ Earley and Goldenberg. 2019., Morrison Foerster. 2019.

⁸ See Ritter, Dubravka, and Douglas Webber. 2019. “Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications.” Federal Reserve Bank of Philadelphia. December. <https://www.philadelphiafed.org/consumer-finance/education-finance/modern-income-share-agreements-inpostsecondary-education-features-theory-applications>

⁹ See Earley and Goldenburg. 2019., Morrison Foerster. 2019.

¹⁰ Id.

affordability and an alignment of incentives with the school. The threshold acts as wage insurance. No such protection exists with private loans.

- ISAs have “windows” or time limits. Income earned after this period cannot be subject to any payment obligation.¹¹ This allows for deferment of payment during periods of hardship.
- Educational ISAs have caps for the maximum amount a student can be required to pay. All ISAs originated by ISA Alliance members have payment caps. These caps ensure a student who earns enough to reach them during the ISA payment term never pays a total obligation disproportional to the cost of the education.

To the extent that a student may pay more than the initial funding amount, such additional amounts paid are not “interest” because they are not a function of the time value of money. Since ISAs are based on the future earnings potential of a student – as opposed to previous credit background or access to a cosigner – there is enormous potential for ISAs to address the needs of workforce training and education programs across a broad population of diverse industries and geographies. These benefits will be particularly beneficial to programs, industries, and populations that lack ready access to public aid (including Dreamers or persons convicted of a felony). ISAs are also being utilized as an alternative to private loans for students who have gap needs between the amount of available federal aid and the total cost of attendance, often because these students don’t have a creditworthy cosigner for affordable loans. ISAs are helping:

- Increase access to postsecondary education and training credentials, skills, and knowledge which can lead to more meaningful, better paying jobs.¹²
- Alignment of incentives for education and training programs to provide “wrap around” career support services to students throughout their education and careers.¹³
- Alignment of incentives for education programs to maintain an affordable tuition.
- Free students to choose their most fulfilling jobs and careers by removing the necessity to earn high incomes in order to pay interest-bearing loan obligations.¹⁴

Applying existing regulation to ISAs may lead to insufficient oversight and transparency. For example, applying an APR-type restriction on ISAs makes little sense¹⁵. APR is an established method of measuring the time-cost of money borrowed and is justified on the policy priority that there are reasonable time-value charges, and unreasonable ones. ISA payment obligations cannot be determined until income is earned, so any APR disclosure in advance of earned income is speculative and misleading. Furthermore, APR disclosures are intended to enable cost-comparison of different credit products. Thus, California required providers of certain small-business financing products to provide estimated APR disclosures. However, ISAs are not

¹¹ Worth noting that private loans can last indefinitely, while federal loans can last up to 25 years. However, when federal loans are forgiven the balance is a taxable event. ISAs never have a principal balance, so when the contract is exhausted, there is no taxable debt forgiveness.

¹² See Ritter and Webber (2019).

¹³ Pollack (2020) at 7.

¹⁴ Ritter and Webber (2019) at 23. Here Ritter and Webber discuss the potential of a law school student graduating and taking a job in public service, representing the low-income clients, or choosing a firm that encourages pro bono work where they lawyer may earn less, but find the job more fulfilling.

¹⁵ See Gardenswartz and Arias. 2020.

similar to loans or to those small-business financing products because they include minimum income thresholds and payment caps, and an APR estimate created using a methodology similar to that required for small business financing would not allow comparing the ultimate cost of an ISA to any other ISA or to loans. Minimum income thresholds, income share, and number of payments should be considered as alternative disclosure requirements. Combined, these metrics provide a meaningful comparison for students between alternatives and a robust formula to measure affordability.

ISAs unique features make them flexible tools to solve different access and affordability issues within a student body, align school incentives, and provide wage insurance against an uncertain future labor market.

Conclusion

For the reasons stated above, the ISA Alliance recommends the CDFPI finds that ISAs are not an extension of credit, and thus should be regulated as a distinct class of financial product. If the CDFPI does find that ISAs are an extension of credit, it should also find the unique characteristics of ISAs require ISA-specific regulations and disclosure requirements to provide appropriate safeguards and transparency while allowing education and training providers to use ISAs to provide greater access and affordability to programs that may lead to students' career and financial advancement.

ISAs have developed and grown in the education and workforce training space in recent years due to strong demand by potential and current students for innovative tuition payment options.¹⁶ ISAs provide new access to marketable education, align school incentives with positive financial outcomes with students, and provide wage insurance for students. Responsible ISA design and use for education and training programs should be encouraged.

The ISA Alliance is eager to engage meaningfully and productively to help create the necessary and appropriate regulatory authorities in order to ensure a responsible, accountable, and transparent market. Please utilize the ISA Alliance as a resource.

Sincerely,



Jordan Wicker
Executive Director

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Invest in Student Advancement

¹⁶ Kenneth P. Brevoort, Phillip Grimm, and Michelle Kambara, "Data Point: Credit Invisibles," The CFPB Office of Research, May 2015, https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf. The CFPB estimates that as many as 26 million Americans are "credit invisible" while another 19 million lack recent enough history to acquire a score.