



Student and Parent Perspectives on Higher Education Financing

FINDINGS FROM A NATIONALLY REPRESENTATIVE SURVEY ON INCOME-SHARE AGREEMENTS

AEI Series on Private Financing in Higher Education

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A M E R I C A N E N T E R P R I S E I N S T I T U T E

Executive Summary

Income-share agreements (ISAs) are a new higher education financing tool meant to supplement or replace student loans. With an ISA, students agree to pay a set percentage of their future income for a set number of years in return for financing for their college educations.

Because the private market for ISAs is small, little is known about the potential demand for the product. Will students and parents be receptive to ISAs or prefer them to traditional student loans? What would a core market for ISAs look like? What features of an ISA do potential recipients like or dislike? What type of student or family might seek out an ISA or opt to use one?

To answer these questions and more, the American Enterprise Institute (AEI) commissioned a nationally representative survey of 400 college and high school students and 400 parents of current and future college students to assess their interest in ISAs. The survey revealed the following conclusions.

- Few survey respondents had heard of an ISA. Across a range of questions, between 23 and 53 percent of survey respondents favored ISAs over traditional private student loans. Results suggest that those who preferred ISAs liked the insurance that ISAs offered over student loans in the instance of lower-than-expected earnings after college.
- When given detailed information to compare an ISA with a loan, such as monthly payment amounts under different income scenarios, more than half of respondents preferred ISAs.

This suggests that many respondents who are at first skeptical of ISAs or do not see their value over student loans change their minds when the two financial products can be compared side by side with specific information about repayment terms.

- Prior focus group research AEI conducted suggests that parents have more difficulty understanding an ISA or have more doubts about this new financial product than they have for student loans. On this issue, survey results are mixed. Parents were no less likely than students to choose ISAs over student loans when answering questions such as whether an ISA is a good alternative to a student loan, whether it would be a good option for their children, and whether they would choose an ISA after seeing different repayment scenarios. But, parents were more likely to answer “unsure” to other questions about ISAs, such as whether an ISA was riskier than a student loan.
- The survey data do not reveal a clear indicator that predicts whether someone would favor an ISA over a student loan. Those who preferred ISAs to loans were not clustered around certain income groups or school types. Risk-averse and risk-tolerant respondents answered questions comparing ISAs and loans similarly. However, there was some indication that those who expected to borrow relatively small amounts (less than \$10,000) expressed a preference for loans over ISAs.

Student and Parent Perspectives on Higher Education Financing: Findings from a Nationally Representative Survey on Income-Share Agreements

This paper is the fourth in a series examining private financing in higher education from a number of perspectives.

Income-share agreements (ISAs) are a new product for financing higher education meant to supplement or replace student loans. As anxieties over college costs have grown in recent years and students and families increasingly worry whether their investment in higher education will pay off, ISAs begin to look like an appealing alternative to borrowing.

With an ISA, students agree to pay a set percentage of their future income for a set number of years in return for financing for their college educations. That differs from a traditional student loan, for which borrowers must pay back a given amount of principal and any accrued interest through fixed monthly payments, regardless of their income.

An ISA has important features that distinguish it from a student loan. First, recipients' payments under an ISA adjust with their income, effectively providing insurance against the downside risk of being unable to make payments on a loan due to unemployment, underemployment, or other financial hardship. Moreover, if their education does not lead to the expected payoff in higher earnings, their payments on an ISA will be commensurately lower.

Student loans that the federal government offers already allow borrowers to tie payments to their incomes through the income-based repayment plan. But undergraduates face annual borrowing limits as low as \$5,500 on these loans.¹ That means if students

need additional capital, they must turn to private student loans or federal Parent PLUS loans, which lack income-based repayment offerings. An ISA is a way for student borrowers to take out additional private financing that still offers an income-based protection.

Another distinctive feature of ISAs is that recipients could pay *more* monthly and in total than with a traditional student loan. If ISA recipients earn a high income after leaving school, they would still be required to make payments for the full number of years stipulated in the ISA contract. ISA recipients therefore face potential upside risk—paying more for their education than they otherwise would have with a loan—in exchange for the protection from downside risk that an ISA offers over a loan.

While interest in ISAs has grown, ISAs are not yet a widely available alternative to student loans. Only a handful of nonprofit and for-profit organizations currently offer ISAs, including 13th Avenue Funding, Base Human Capital, and Education Equity.² Purdue University recently initiated its Back a Boiler program, through which some juniors and seniors at the school are entering into ISAs as an alternative to borrowing private student loans or their parents borrowing federal Parent PLUS loans.³

State and federal policymakers have shown some interest in making publicly subsidized ISAs available to students. These include the Pay It Forward proposal

in Oregon and a proposal from Gov. Jeb Bush's 2016 presidential campaign to replace the federal student loan program with a subsidized ISA model.⁴

Others are working to create a legal and regulatory framework for the supply side of a potential ISA marketplace. Congressmen Marco Rubio (R-FL), Todd Young (R-IN), and Jared Polis (D-CO) sponsored legislation in the 114th Congress that would clarify how federal law treats ISAs, while establishing basic consumer protections that providers must include in their products—reforms meant to foster a private market for ISAs.⁵

Fundamental questions also remain on the demand side of this fledgling market. Will students and parents be receptive to ISAs or prefer them to traditional student loans? What would a core market for ISAs look like? What features of an ISA do potential recipients like or dislike? What type of student or family might seek out an ISA or opt to use one if given the option?

Some research exists in this realm, although it is not without limitations. A 2013 survey by Parthenon-EY, a consultancy for education providers, found that around 11 percent of students would likely use an ISA to pay for college.⁶ But the survey focused on an unusual ISA model that involved “pools” of students whose collective repayments influenced the amount each student was obligated to repay.

A 2015 *Money* and Kaplan Test Prep poll found that just 23 percent of parents of college-bound students said allowing “investors to pay all or part of a student’s tuition in return for a percentage of the student’s income” was a good solution to rising college costs and student debt. However, it was the only question about private financing in a survey otherwise focused on increasing government subsidies for college.⁷

In 2016 the American Institutes for Research conducted 21 paired interviews with high school students and parents about ISAs. But the research compared unsubsidized private ISAs to subsidized federal student loans with income-based repayment options, and it is not clear whether the interviewees preferred loans, ISAs, or federal subsidies for a financial product.⁸

AEI has also explored questions about potential demand for ISAs via focus group research. In the 2016 report *Student and Parent Perspectives on Higher Education Financing: Findings from Focus Groups on Income-Share Agreements*, Alexander Holt found that many students and parents reacted positively toward ISAs and appreciated the insurance ISAs offer against unaffordable payments. At the same time, other participants disliked the idea of potentially paying back more on an ISA than a loan if they earned a high income. Additionally, parents were more suspicious of ISAs than students and had more difficulty understanding how this form of financing differed from traditional student loans.⁹

This report builds on the findings from the focus group research with a first-of-its-kind, nationally representative survey of 400 college and high school students and 400 parents of current and future college students about their likely interest in ISAs. The goal was to examine student and parent preferences for ISAs versus traditional private student loans and better understand characteristics of those inclined to choose an ISA.

A full explanation of the survey methodology is included in Appendix A.¹⁰ The margin of error for the full sample of parents and students is +/- 3.5 percent. The margins of error for the student and parent samples are +/- 5.5 percent and +/- 5.9 percent, respectively. Differences in survey responses discussed in this paper are statistically significant at the 0.05 level, unless otherwise noted.

To increase the statistical power of the survey results and help simplify the discussion, the findings are presented by combining both samples of students and parents (n = 800), unless specified differently. However, an entire section of this paper also discusses cases in which students and parents differed in their preferences for student loans and ISAs.

General Awareness and Understanding of ISAs

To start, almost none of the survey respondents had heard of ISAs before taking the survey. Only 7 percent

Terminology for Five Core Survey Questions

In the report, we continually refer to a core set of five survey questions. To represent each survey question consistently, we developed a shorthand term for each item listed below:

“Good Option for Me”

- [Given a brief description of an ISA] For whom—if anyone—do you think an income share agreement would be a good option?

An income share agreement would be a good option for me or my child.

“Good Option for Others”

- [Given a brief description of an ISA] For whom—if anyone—do you think an income share agreement would be a good option?

An income share agreement would be a good option for others, but not for me or my child.

“Good Alternative”

- [Given a brief description of an ISA] Do you think an income share agreement seems like a good alternative to a traditional student loan, or a bad alternative?

“Risk”

Which of the following do you agree with more?

1. Traditional student loans are the riskier choice because you have to keep paying the same amount back each month no matter how much money you make, while an income share agreement would not require as much of a payment if your income is lower.
2. Income share agreements are the riskier choice because you don’t know how much money you’ll have to pay back each year, while a student loan has a set amount you pay each month that doesn’t change.
3. Unsure.

“Income Scenario”

Now we’d like you to think about the differences between student loans and income share agreements.

Now imagine you have two different products to choose from to obtain \$10,000 for your education.

OPTION A: A student loan with a 10 percent interest rate to be paid back over 10 years

OPTION B: An income share agreement that requires 3.5 percent of your income for 10 years

The table below shows the different monthly payments required for each option under three different income scenarios that each have the same chance of occurring:

SCENARIO 1: You or your child never earn(s) any income.

SCENARIO 2: You or your child earn(s) a low income that starts at \$30,000, with small annual increases for 10 years.

SCENARIO 3: You or your child earn(s) a high income that starts at \$80,000, with big annual increases for 10 years.

Which product would you prefer for your (or your child’s) education?

1. OPTION A: Student loan
2. OPTION B: Income share agreement
3. Unsure.

of students and 5 percent of parents had heard of an ISA. This was unsurprising given the novelty of ISAs and their limited reach in the private market. Nearly all respondents thus began the survey with something of a blank slate.

Despite this lack of awareness, survey results suggest that a sizeable share of respondents are receptive to the idea of an ISA if provided with sufficient information about the product. Favorable responses toward ISAs ranged from a low of 23 percent when respondents were first introduced to the concept with limited information to more than half of respondents when they were provided with detailed information about ISAs.

However, many respondents were uncertain or confused about the product. A large share of respondents answered “unsure” to many of the questions offering that option, which suggests they needed more information or had difficulty understanding how an ISA works and its potential advantages and disadvantages. Survey results also indicate that a core group of students and parents think a student loan is better than an ISA no matter how the comparison is framed or how much information they receive about ISAs. These findings are discussed in more detail below.

Is an ISA a Good Alternative to a Student Loan?

The first survey question about ISAs began with a description of the basic concept. It did not specify key details, such as the exact share of income or the length of time a recipient would pay. It also did not compare an ISA to a student loan.

An “income share agreement” is an alternative to traditional student loans as a way to pay for college tuition. Under an income share agreement, a student receives funds to pay for their education in exchange for a fixed percentage of their taxable income for a set number of years after they graduate.¹¹

We then asked respondents to indicate if they thought, based on that description, that an ISA was a good alternative to a student loan (called the “good alternative” question). As shown in Table 1, 42 percent of respondents indicated that an ISA was a very good or somewhat good alternative to a traditional student loan. However, 21 percent believed it was a somewhat bad or very bad alternative, 22 percent of respondents were indifferent between the two financing products, and 15 percent were unsure.

Afterward we asked respondents a more specific question about ISAs: for whom, if anyone, would an

Table 1. Responses to Initial Survey Questions About ISAs

ISAs Are a Somewhat Good or Very Good Alternative to Student Loans¹	ISAs Are a Somewhat Bad or Very Bad Alternative to Student Loans²	ISAs Are Neither a Good nor Bad Alternative to Student Loans	Unsure
42%	21%	22%	15%
ISAs Would Be a Good Option for Me	ISAs Would Be a Good Option for Others, But Not for Me	ISAs Would Not Be a Good Option for Anyone	Unsure
21%	30%	17%	32%

Notes: The margin of error is +/- 3.5 percent. 1. Combined responses for two separate answers: ISAs are a very good alternative (12 percent), and ISAs are a somewhat good alternative (30 percent). 2. Combined responses for two separate answers: ISAs are a very bad alternative (12 percent), and ISAs are a somewhat bad alternative (9 percent). For the “good option for me” question, n = 774. (For an explanation, see note 11.)

Source: Author’s calculations.

ISA be a good option (based on the initial description)?¹² Table 1 shows that 21 percent indicated an ISA would be a good option for them personally or their children (called the “good option for me” question). More respondents (30 percent) thought an ISA would be a good option for other students but not for them personally or their children (called the “good option for others” question), and 17 percent thought an ISA would not be a good option for anyone. These results suggest that roughly one-fifth of students and parents strongly dislike the idea of ISAs, at least when initially learning about the product.

The Riskier Option: Student Loan or ISA?

One of an ISA’s primary benefits is that it protects recipients from having to make unaffordable payments. With an ISA, payments are always a fixed share of income. If students make a low income after college, their payments are commensurately low. Despite this benefit, many student and parent participants in AEI’s focus groups voiced concerns that ISAs were as risky, or possibly riskier, than a student loan.¹³

Focus group participants worried that ISA recipients could pay more on a monthly basis and in total with an ISA than if they had taken out a loan (also called upside risk). Survey respondents echoed these concerns about upside risk in open-ended comments when asked why they thought ISAs were or were not a good option:

The person that takes that [ISA] could end up getting a better job than expected and end up paying more than he should.

If my education doesn’t cost that much and I end up

getting a good-paying job then it will be a disadvantage to me because instead of paying off the loan fast I would be paying more and more for no reason.

I don’t like the idea of taking away a ‘fixed percentage of taxable income’ for a few years. You might end up paying twice the amount you owe. It just isn’t worth it without more facts to the puzzle.

These comments alone do not tell us the extent to which respondents were concerned about upside risk; many comments were vague and unrelated to risk altogether. In turn, to assess the share of respondents that might hold these views, we asked them directly whether an ISA or a student loan was riskier (called the “risk” question). We provided respondents with a more detailed description of the differences between an ISA and a student loan and asked:

Which of the following do you think you agree with more?

1. Traditional student loans are the riskier choice because you have to keep paying the same amount back each month no matter how much money you make, while an income share agreement would not require as much of a payment if your income is lower.
2. Income share agreements are the riskier choice because you don’t know how much money you’ll have to pay back each year, while a student loan has a set amount you pay each month that doesn’t change.
3. Unsure.

Table 2. Are Student Loans or ISAs the Riskier Option?

Student Loans Are the Riskier Option	ISAs Are the Riskier Option	Unsure
34%	38%	28%

Note: The margin of error is +/- 3.5 percent.
Source: Author’s calculations.

Table 3. Comparing Responses About Risk with Preferences for ISAs Versus Loans

	Student Loans Are the More Risky Option	ISAs Are the More Risky Option	Unsure	Total	Number of Respondents
All Students and Parents	33%	38%	29%	100%	774
ISAs Would Be a Good Option for Me	65%*	23%*	11%*	100%	164
ISAs Would Not Be a Good Option for Me	24%*	42%*	33%*	100%	610

Notes: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level. Number of respondents is weighted. Number of respondents does not total 800 because 26 respondents who answered yes to multiple, mutually exclusive questions regarding for whom an ISA would be a good option are excluded from this tabulation. See note 11 for a description of the “good option for me” question.

Source: Author’s calculations.

The results indicate that many respondents were indeed concerned about the upside risk inherent to an ISA. In fact, respondents were closely divided as to which they saw as the bigger risk—fixed payments on a student loan that they must make regardless of their income, or the possibility of paying more with an ISA if their incomes do not end up lower than expected. Altogether, 34 percent of respondents said student loans were riskier, 38 percent said ISAs were riskier, and 28 percent said they were unsure (see Table 2).

Perhaps unsurprisingly, respondents who indicated an ISA was a good option for themselves or their children were much more likely to say that student loans were riskier. As shown in Table 3, 65 percent of respondents who said an ISA would be a good option for them indicated that a student loan was riskier than an ISA. Just 23 percent of them said an ISA was riskier.

The results are nearly flipped for those who said an ISA was *not* a good option for themselves, barring the larger share of respondents indicating “unsure.” The results show that 43 percent of the respondents who said an ISA would not be a good option for them personally also said an ISA was the riskier option, while just 23 percent said loans were riskier.

A Detailed Comparison of Loans and ISAs

The discussion thus far has dealt only with a few questions based on simple descriptions of ISAs. Now we turn to a question in which respondents were shown comparisons of ISAs and student loans that featured monthly payments and different income scenarios.

Respondents were asked to imagine that they could end up in any one of three future income scenarios after completing school (called the “income scenario” question): earning zero income after school for 10 years; earning an initial income of \$30,000, with small annual increases to \$43,000 over 10 years; and earning an initial income of \$80,000, with big annual increase to \$114,000 over 10 years.

Survey participants were also asked to imagine they needed to borrow \$10,000 to finance their education. Using Table 4, respondents were then asked to choose between a student loan and an ISA by comparing the monthly payment needed to repay each one.¹⁴

The monthly payments reflected a student loan with a 10-year repayment term and a 10 percent fixed interest rate, consistent with rates typically found on fixed-rate private student loans. The

Table 4. Information Provided to Survey Respondents to Compare ISAs and Loans

	Scenario 1: No Income (\$0)	Scenario 2: Low Income (\$30,000–\$43,000)	Scenario 3: High Income (\$80,000–\$114,000)
Option A: Student Loan	\$173 per month	\$173 per month	\$173 per month
Option B: Income-Share Agreement	\$0 per month	\$88–\$125 per month	\$233–\$332 per month

Source: AEI-Echelon Insights survey on income-share agreements.

monthly ISA payments were equal to 3.5 percent of after-graduation income. Survey respondents were provided with this information.

We chose these terms to make the loan and ISA roughly equivalent in present value terms, assuming that the student had an equal probability of ending up in any of the three income scenarios. An even more complete comparison would include the total lifetime payments—not just monthly payments—on the loan and ISA in present value terms. We did not include such information to keep the question as simple and understandable as possible.

Based on this information, more than half of respondents (53 percent) chose the ISA, 28 percent chose the student loan, and 18 percent were unsure (see Table 5). That is a substantially larger share of respondents in favor of ISAs than in any of the earlier

questions. For instance, only 42 percent of respondents thought an ISA was a very good or somewhat good alternative to a traditional student loan; only 30 percent said it would be a good option for students other than themselves.

The responses to the “income scenario” question may be a more accurate reflection of student and parent preferences because the question is based on more specific information about the two products than earlier questions. The results also show that, on net, about one-fifth of respondents change their preferences from loans to ISAs when they see specific comparisons between the two products.

We can gain more insight about respondents switching their preference to an ISA when they are provided with more information by comparing their responses to different questions. For example, Table 5

Table 5. Comparing Initial View of ISAs with Responses to Income Scenarios

	Three Possible Income Scenarios: Prefer Student Loan	Three Possible Income Scenarios: Prefer ISA	Unsure	Total	Number of Respondents
All Students and Parents	28%	53%	18%	100%	774
ISAs Would Be a Good Option for Me	14%*	82%*	4%*	100%	164
ISAs Would Not Be a Good Option for Me	32%*	46%*	22%*	100%	610

Notes: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level. Number of respondents is weighted. Number of respondents does not total 800 because 26 respondents who answered yes to multiple, mutually exclusive questions regarding for whom an ISA would be a good option are excluded from this tabulation.

Source: Author’s calculations.

Table 6. Comparing Initial Views on the Riskiness of Loans and ISA with Responses to Income Scenarios

	Three Possible Income Scenarios: Prefer Student Loan	Three Possible Income Scenarios: Prefer ISA	Unsure	Total	Number of Respondents
All Students and Parents	29%	53%	18%	100%	800
ISAs Are the More Risky Option	20%*	73%*	7%*	100%	269
Student Loans Are the More Risky Option	45%*	43%*	13%*	100%	306

Notes: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level except those in the unsure column. Number of respondents in subcategories does not total 800 because 225 respondents who answered “unsure” to the risk question shown in the left column are excluded for simplicity. Number of respondents is weighted.

Source: Author’s calculations.

shows that 46 percent of respondents who initially indicated that an ISA was not a good option for them later said they would actually prefer an ISA when shown the three income scenarios.

A much smaller percentage (14 percent) moved in the opposite direction—respondents who thought an ISA would be good for them initially instead chose the student loan in the scenario. The pattern is similar among those who said that an ISA would be a good option for other students.

How respondents answered the “income scenario” question and the preceding “risk” question is also instructive. Seventy-three percent of the respondents who initially said an ISA was riskier chose the ISA over the loan when shown the scenarios (Table 6). It is another indication that many respondents who have a negative first impression of ISAs favor ISAs after receiving more information.

However, many respondents still like student loans, even if they do believe loans are the riskier option and they are provided with detailed information. For example, 45 percent of those who said a student loan was riskier than an ISA still chose the student loan over an ISA in the “income scenario” question. This may be because some respondents expect to earn a stable and sufficient income to repay a loan or believe

they can adjust their finances to repay the loan even if they suffer an unexpected hardship.

Therefore, respondents may have decided that the risks inherent to a student loan do not apply to them personally or that they could afford to take those risks and forgo the insurance that an ISA provides in favor of fixed, monthly loan payments. Or perhaps they still prefer the student loan because of its familiarity, even if it could be riskier.

Do Parents and Students Differ in Their Understanding of and Preferences for ISAs?

The prior AEI focus group research indicated that parents had more difficulty understanding ISAs than students. Holt concluded:

[Parents] had more trouble understanding ISAs, even though they assumed they understood the concept better than their children would. They had difficulty internalizing the idea that the ISA did not come with an interest rate, that interest would not accrue, and that there was not a set amount to pay back. They seemed more at ease thinking about debt and loans and a bit frustrated by this new concept.¹⁵

To the extent that parents make financial aid decisions for dependent students, or opt to borrow on their child's behalf, such a dynamic would have implications for the future viability of ISAs and how they are marketed. If dependent students are inclined to choose an ISA but their parents do not see its benefits, then their parents may steer them toward a loan instead.

ISA providers may need to place more emphasis on overcoming confused, uncertain, or suspicious parents if they are to expand the market, even if more students would prefer an ISA. In this section, we look for distinctions between how students and parents answered the survey questions.

The survey results offer a mixed view on this matter. Despite parents struggling more in the focus groups to understand ISAs, students and parents frequently responded to questions about ISAs in similar ways.¹⁶

For example, there was no difference in how students and parents responded to the "income scenario" question. They chose loans, chose ISAs, or answered "unsure" at the same rates. This was also the case for the "good alternative" question. And when asked for whom—if anyone—an ISA would be a good option, students and parents responded that an ISA would be a good option for themselves or their children at the same rate.

Despite those similarities, parents did exhibit more negative or uncertain responses to ISAs in some instances. Students and parents expressed different views regarding whether an ISA would be good for students other than themselves or their children.

As displayed in Table 7, parents were half as likely to say that an ISA would be a good option for others. They were also more likely to say they were unsure about who should use an ISA or whether a traditional student loan was riskier than an ISA. Specifically, 12 percent more parents than students said they were unsure for whom an ISA would be a good option. Table 8 shows that 10 percent more parents were unsure whether student loans or ISAs were the riskier option.

Is There a Profile of Respondents Who Prefer an ISA?

So far this paper has discussed the share of respondents who prefer ISAs over student loans and how their preferences changed depending on the question asked, the amount of information provided, and whether respondents were students or parents. Next, we explore whether respondents who favored ISAs over loans had certain characteristics. In other words, we attempt to describe the types of students or parents likely to seek out an ISA or choose one over a loan.

For this task, we compared respondents' preferences for loans or ISAs with their expected amount borrowed, their expected postgraduation income, their current household income, the type of schools they attended, and their aversion to financial risk, among other characteristics. Surprisingly, no clear profile of those who favored ISAs emerged from the survey results. The only pertinent factor seemed to be the amount students planned to borrow.

Table 7. Comparing Student and Parent Views About Who Should Use an ISA

	ISAs Would Be a Good Option for Me	ISAs Would Be a Good Option for Others, But Not for Me	ISAs Would Not Be a Good Option for Anyone	Unsure
Students	20%	40%*	14%	26%*
Parents	23%	20%*	20%	38%*

Notes: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level. Number of respondents is weighted. The margins of error for the student and parent samples are +/- 5.5 percent and +/- 5.9 percent, respectively. For the parent sample, n = 395, and for the student sample, n = 379. They do not each total 400 because 5 parents and 21 students who answered yes to more than one of these questions, which are mutually exclusive, are excluded from this tabulation.

Source: Author's calculations.

Table 8. Comparing Student and Parent Views on Which Option Is the Riskier Way to Pay for College

	Student Loans Are the Riskier Option	ISAs Are the Riskier Option	Unsure
Students	40%*	37%	23%*
Parents	27%*	39%	33%*

Note: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level. Number of respondents is weighted. The margins of error for the student and parent samples are ± 5.5 percent and ± 5.9 percent, respectively. For both student and parent samples, $n = 400$.

Source: Author's calculations.

Those who planned to borrow the least were most likely to favor student loans over ISAs. There was also more evidence to support our finding that students respond more favorably to ISAs when information is tailored to their particular circumstances. In some instances, the full sample size ($n = 800$) was not large enough to gauge potential differences among certain subgroups of respondents. A larger survey may reveal clearer differences between the respondents who prefer ISAs over loans, and vice versa.

Amount of Borrowing. The amount that respondents expected to borrow for school (or expected their children to borrow) had some bearing on whether respondents preferred ISAs. Those who expected to borrow the least (between \$1 and \$10,000) were more likely to say that an ISA would not be a good option for them and that an ISA is riskier than a student loan.¹⁷ Specifically, 82 percent of respondents in the low-borrowing group said an ISA was not a good option for them, and 55 percent said an ISA was riskier than a student loan. Those results were smaller among respondents who expected to borrow more than \$10,000, with 69 percent saying an ISA would not be a good option for them, and 41 percent indicating that an ISA was the riskier option.¹⁸

One way to interpret that result is that students and families who intend to borrow relatively small amounts do not see the advantages of an ISA relative to a student loan. That makes sense; an ISA provides insurance against downside risk, and someone who borrows a small amount in total may not consider that downside risk large enough to warrant insurance.

There was another instance in which the amount respondents planned to borrow seemed to affect their opinion of ISAs. Those who planned to borrow between \$10,000 and \$19,000 were the most likely to choose the ISA on the “income scenario” question.¹⁹ That may be because those three income scenarios compared monthly payments for a \$10,000 loan with those for a \$10,000 ISA. Perhaps an ISA's benefits were more apparent to respondents who planned to borrow the amount shown in the examples.²⁰ Students and parents may be more inclined to choose an ISA if they receive information tailored to their specific circumstances.

Risk Aversion. Before asking respondents about ISAs, the survey included two common research questions used to determine someone's tolerance for financial risk. The first question asked respondents their willingness to take financial risks, and the second asked how respondents would hypothetically allocate money to a risky investment after winning the lottery.²¹ We chose these questions because in controlled experiments that involved actual money, individuals' responses to these two questions closely mirrored their tolerance to take real financial risks.²²

We hypothesized that respondents who exhibited a low tolerance for risk based on those questions would prefer ISAs because ISAs offer a form of insurance against downside risk. However, we found no correlation between respondents' risk tolerances (as measured by the two questions we asked) and their preferences for ISAs or loans.

For example, there was no difference in how the risk-averse and risk-tolerant respondents answered the question comparing ISAs and loans under the three income scenarios nor the question regarding whether a student loan or an ISA was riskier. That is, the risk-averse group was no more likely to choose an ISA than was the risk-tolerant group, and both groups answered “unsure” at nearly identical rates.

These similarities may be a result of respondents considering student loans and ISAs to be risky in different ways. Each product does indeed carry its own risk relative to the other product—loans have downside risk, and ISAs have upside risk. Or perhaps risk-averse respondents, who in theory should prefer an ISA, are averse to the riskiness of a novel financial product, thus confounding the survey results.

It may also be the case that traditional risk-tolerance questions do not predict how people think and feel regarding ISAs and student loans. Further research might gauge people’s willingness to buy insurance or warranties—and how much they would pay for a given amount of insurance—to determine whether other types of risk aversion predict preferences for ISAs.

Expected Income After Graduation. We asked students to provide information on their expected income two years after leaving school. When comparing this information to students’ preferences for ISAs and student loans, we found that expected income generally did not affect respondents’ likelihood of preferring either financial product.

There is one unexpected exception to that finding: students who expected to have the lowest earnings two years after graduation—less than \$30,000—were more likely to say an ISA was not a good option for them (see Table 9).²³ We would expect to find the opposite. With an ISA, low-earning graduates make low to no payments because payments adjust to income. With a student loan, low-earning graduates still must make their fixed monthly payments. Theory suggests then that low-earning individuals should prefer an ISA over a loan.

When we look at responses to the “income scenario” question, we do find that borrowers who

expected to earn the least after school chose ISAs over loans at about the same rate as their higher-earning counterparts—49 percent and 52 percent respectively—not enough difference to be statistically significant. Still, we would expect that these respondents would be slightly *more* likely to choose ISAs. It is puzzling that low-earning respondents opted for the ISA at only the same rate as other students.²⁴

Household Income, Race, Gender, and Type of Institution Attending. Finally, just as we did not find that ISA preferences aligned with risk preferences, we saw no relationship between respondents’ household incomes and their preferences for ISAs over student loans.²⁵ Nor did we generally find relationships based on race or gender.

The type of school students attended also did not appear to make a difference in preferences for ISAs over loans either.²⁶ Across a range of questions, students attending two-year colleges did not seem to favor ISAs or loans at different rates compared to those attending four-year colleges.²⁷

Conclusion

This survey’s results indicate that up to half of students and parents are open to using an ISA to finance college, particularly when shown detailed comparisons with an equivalent student loan. This suggests that ISAs could replace a significant share of the student loan market now dominated by the federal government.

As was stated earlier, undergraduates are limited in how much they can borrow in federal student loans each year. As a result, each year some 6 percent of undergraduate students borrow \$9 billion in private loans, while 5 percent of undergraduates’ parents borrow \$12 billion using the federal Parent PLUS loan program.²⁸ These loans lack income-based repayment protections and have interest rates that can exceed 10 percent.²⁹

If policymakers look to reduce the federal government’s role in student lending in years to come—or opt not to increase borrowing limits over time,

Table 9. Students' Expected Earnings Compared with Views on ISAs

	ISAs Would Be a Good Option for Me	ISAs Would Not Be a Good Option for Me	Total	Number of Respondents
All Students	20%	80%	100%	379
Students Who Expect to Earn Less Than \$30,000 Two Years After School	8%*	92%*	100%	54
Students Expects to Earn More Than \$30,000 Two Years After School	22%*	78%*	100%	325

Notes: *Differences between percentages in the two subcategory rows are statistically significant at the 0.05 level. Number of respondents is weighted. Number of respondents does not total 400 because 21 respondents who answered yes to multiple, mutually exclusive questions regarding for whom an ISA would be a good option are excluded from this tabulation.

Source: Author's calculations.

eroding the purchasing power of federal loans—then the need for additional sources of private financing will only grow.

The survey also makes clear that a core group of students and parents strongly prefer student loans to ISAs, even after they are provided with detailed information comparing the two products. These respondents said they did not like that they might pay more on an ISA than a loan if their incomes ended up higher than expected or that payments can increase as a recipient's income rises.

However, this survey did not examine one way that ISAs can mitigate those concerns: ISA providers can cap the total amount a recipient would ever pay. We excluded this feature from the research to keep the survey manageable. Future research should explore how a payment cap affects student and parent responses to ISAs. Our prior focus group research suggests that a cap on total payments tends to *reduce* support for ISAs because students and parents tended to

see the cap as an amount that they *would pay* instead of as an upper limit.

That is just one of many areas for further research that the findings from this survey suggest. Future surveys should also experiment with different types of questions about risk to help identify what types of risk aversion might predict a respondent's preference for an ISA. Such work could help better reveal the profile of a student or parent who prefers an ISA.

There is also the puzzling result from this survey in which students who expected to earn the least after leaving school were less likely to prefer an ISA. Given that this is the very group that should prefer an ISA, future research should aim to determine what might explain this finding.

In the meantime, this first major survey about attitudes toward ISAs demonstrates that there is enough interest among parents and students to support an ISA market that is much larger than the one that exists today.

About the Author

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Appendix: Survey Methodology

AEI commissioned Echelon Insights, a public opinion and research firm, to design and administer a 40-question, 10-minute survey for current college students and parents of high school or college students. AEI and Echelon Insights collaborated on designing the questions asked in the survey. Echelon Insights contracted with YouGov, a separate market research company, to administer the survey online between August 9, 2016, and August 23, 2016.

For the student survey, YouGov interviewed 445 respondents who were then matched down to a sample of 400 to produce the final dataset. The respondents were matched to a sampling frame on gender, age, and race. The frame was constructed by stratified sampling from the full 2015 Current Population Survey School Enrollment Supplement sample with selection within strata by weighted sampling with replacements (using the person weights on the public use file).

The frame was a subset of respondents currently enrolled in college or in vocational or professional education. The matched cases were weighted to the sampling frame using propensity scores. The matched cases and the frame were combined, and a logistic regression was estimated for inclusion in the frame.

The propensity score function included age, gender, race/ethnicity, and region. The propensity scores were grouped into deciles of the estimated propensity score

in the frame and post-stratified according to these deciles. The final weights were then post-stratified to match the joint distribution of gender by four categories of race of the sampling frame.

For the parent survey, YouGov interviewed 488 respondents who were then matched down to a sample of 400 to produce the final dataset. The respondents were matched to a sampling frame on gender, age, race, education, party identification, ideology, and political interest. The frame was constructed by stratified sampling from the full 2013 American Community Survey sample with selection within strata by weighted sampling with replacements (using the person weights on the public use file).

The frame was a subset on households with children currently enrolled in high school or visiting college, and then a subset on parents in those households was included in the frame. The propensity score function included age, gender, race/ethnicity, years of education, and census region. The propensity scores were grouped into deciles of the estimated propensity score in the frame and post-stratified according to these deciles. The sample was then post-stratified to a distribution of gender by four categories of education to construct the final weights.

The margin of error for the full sample of parents and students combined is +/- 3.5 percent. The margin of error for the student survey is +/- 5.5 percent. The margin of error for the parent survey is +/- 5.9 percent.

Notes

1. For more information about federal student loan limits, see US Department of Education, Federal Student Aid, “Subsidized and Unsubsidized Loans,” <https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized>.
2. For a discussion of the marketplace of ISA providers, see Jon Marcus, *Students’ Futures as Investments: The Promise and Challenges of Income-Share Agreements*, American Enterprise Institute, March 10, 2016, www.aei.org/publication/students-futures-as-investments-the-promise-and-challenges-of-income-share-agreements/.
3. For an overview of the Back a Boiler program, see Purdue Research Foundation, “Back a Boiler,” 2016, www.purdue.edu/backaboiler/overview/BackABoiler-Overview.pdf. The federal Parent PLUS loan program allows parents of dependent undergraduate students to borrow up to the cost of attendance with no other annual or lifetime limit. See US Department of Education, Federal Student Aid, “PLUS Loans,” 2016, <https://studentaid.ed.gov/sa/types/loans/plus>.
4. The Oregon Pay It Forward proposal promised residents free four-year degrees in exchange for 3.5 to 4 percent of their earnings over 20 years. The money that students contribute back to the state would be directed to help provide new funding for future students. The widely publicized Pay It Forward proposal included many of the elements of ISAs, except the Oregon government provided the original capital. See Oregon Higher Education Coordinating Commission, “Pay It Forward,” www.oregon.gov/HigherEd/Documents/HECC/06_Jun-12-14/8.2a%20Pay%20It%20Forward%20Proposal%20V9.pdf. Under the plan Gov. Jeb Bush proposed for his campaign during the 2016 Republican primary election, the federal government would replace the existing federal loans system with one that would let all eligible students finance their education by agreeing to pay back a small share of their future income. Specifically, the federal government would extend a \$50,000 line of credit in a flexible account to high school graduates who wished to enroll in postsecondary education or training. Students could draw that money down at their own pace to pay for their education and would then repay 1 percent of their income for 25 years for every \$10,000 they used, subject to a total lifetime payment limit of 1.75 times the amount of financing that they drew down. For more information about Gov. Bush’s proposal, see Andrew Kelly and Jason Delisle, “Jeb Bush’s Plan to Help Students Pay for College,” *National Review*, January 18, 2016, www.nationalreview.com/article/429921/jeb-bush-higher-education-reform-financing-college-tuition. Full disclosure: the author of this paper helped develop Gov. Bush’s proposal as an informal adviser to his campaign.
5. Marco Rubio, “S.2186 Investing in Student Success Act of 2015,” US Senate, October 20, 2015, www.congress.gov/bill/114th-congress/senate-bill/2186/text; and Todd Young, “H.R.3432 - Investing in Student Success Act of 2015,” US House of Representatives, July 29, 2015, www.congress.gov/bill/114th-congress/house-bill/3432.
6. The Parthenon-EY survey included 1,100 students and overall found that between 8 and 14 percent would sign up for an ISA. See Parthenon-EY, “Findings from Rethinking Education Finance Survey” (presentation, 13th Avenue Funding, February 19, 2013), <https://docs.google.com/file/d/0BovSp7rZv6RhRWJRTW9WYW9tNEk/edit>.
7. Kim Clark, “This Is the Most Popular Solution to the College Affordability Crisis,” *Money*, November 10, 2015, <http://time.com/money/4103508/parent-survey-college-affordability>.
8. American Institutes for Research, *Searching for the Best Deal*, January 2016, www.air.org/resource/searching-best-deal-how-students-and-their-parents-view-income-share-agreements.
9. Alexander Holt, *Student and Parent Perspectives on Higher Education Financing: Findings from Focus Groups on Income-Share Agreements*, American Enterprise Institute, December 9, 2016, www.aei.org/wp-content/uploads/2016/11/Student-and-Parent-Perspectives-on-Higher-Education-Financing.pdf.
10. The full list of survey questions can be found at <https://www.aei.org/wp-content/uploads/2017/01/ISA-Survey-Question-Key.pdf>.

11. Ibid.

12. This question was structured as four successive questions to which respondents could answer yes or no. Respondents therefore answered each question; they were not asked to select one of the four options. While their answers should have been mutually exclusive (answering yes that ISAs would be a good option for yourself precludes answering yes that ISAs would not be a good option for anyone), 5 parents and 21 students answered yes to more than one question. We exclude these respondents when displaying and discussing the results for that question.

13. Holt, *Student and Parent Perspectives on Higher Education Financing*.

14. The monthly payments reflected a student loan with a 10-year repayment term and fixed interest rate of 10 percent, consistent with rates typically found on fixed-rate private student loans. The monthly ISA payments were equal to 3.5 percent of after-graduation income. Survey respondents were provided with this information. We chose these terms to make the loan and ISA roughly equivalent in present value terms, assuming that the student had an equal probability of ending up in any of the three income scenarios. An even more complete comparison would include the total lifetime payments—not just monthly payments—on the loan and ISA in present value terms. We did not include such information to keep the question as simple and understandable as possible.

15. Holt, *Student and Parent Perspectives on Higher Education Financing*.

16. Ibid.

17. The comparison between the amount borrowed and whether respondents thought an ISA would be a good option for themselves is statistically significant at the 0.05 level. The comparison between the amount borrowed and the question regarding which product is riskier is statistically significant at the 0.10 level but is close to being significant at the 0.05 level. We excluded respondents who did not expect to borrow for this comparison.

18. Respondents were given the option to indicate a borrowing amount in \$10,000 increments with the highest option being \$30,000 or more. For this part of the analysis on borrowing amounts, for statistical power, responses were assigned to create two borrowing groups: those who plan to borrow between \$1 and \$10,000 ($n = 112$) and a second group of those who plan to borrow more than \$10,000, which combines the highest three categories of borrowing ($n = 356$) with any remaining students and parents who did not plan to borrow ($n = 197$) or answered “unsure” ($n = 122$) removed from the comparison.

19. This finding is based on the raw responses that use \$10,000 incremental borrowing categories, unlike the other analyses based on borrowing amounts for which those categories are combined to make larger groups.

20. The differences in responses between those who planned to borrow \$10,000–\$19,000 and those who planned to borrow less (but not zero) are statistically significant at the 0.05 level. The differences in responses between those who planned to borrow \$10,000–\$19,000 and those who planned to borrow more are statistically significant at the 0.10 level but are close to being significant at the 0.05 level.

21. The first question about risk asked if respondents were fully prepared to take financial risk, allowing them to answer on a scale of 1 to 10. The lottery question asked respondents to choose how they would invest \$100,000 in lottery winnings in a bet that could either double their investment or reduce it by half. They had the option to invest amounts between \$0 and \$100,000 in \$20,000 increments, creating six possible answers to the question. The question is based on another survey question from a report by Thomas Dohmen et al., “Individual Risk Attitudes: New Evidence from a Large, Representative, Experimentally-Validated Survey” (discussion paper, Institute for the Study of Labor, Bonn, Germany, September 2005), <http://ftp.iza.org/dp1730.pdf>. For a full text of the question, visit <https://www.aei.org/wp-content/uploads/2017/01/ISA-Survey-Question-Key.pdf>. We compared preferences for ISAs and loans with respondents’ answers to the risk questions using the raw responses and by combining the responses to create a risk-averse and a risk-tolerant group to create a larger sample size. Respondents were assigned to the risk-tolerant group if they opted for the most risky and second most risky answers to both risk questions.

22. Dohmen et al., “Individual Risk Attitudes.”

23. Fourteen percent of student respondents said they expected to be earning less than \$30,000 two years after leaving school. For this analysis, to create larger subgroups and gain statistical power, responses are collapsed into two groups: those who expect to earn less than \$30,000 shortly after leaving school, and those who expect to earn more. The \$30,000 or less

category is the original category respondents could choose on the survey; the other category collapses six categories of expected earning shown in \$10,000 increments with the highest option being \$80,000 or more.

24. Students who expected to earn the highest incomes (\$60,000 or more) might have understood that loans would probably be better for them than ISAs, but the evidence is weak. Students who expect to earn high incomes two years after school would pay more on an ISA than if they had taken out a loan. On the question about income scenarios, 37 percent of those who expected to earn the highest incomes opted for the loan, while only 27 percent of students who expected to be earning less than \$60,000 did so. Half of students who expected to have high earnings said the ISA was a bad alternative to a student loan, while only 38 percent of those who expected to earn less than \$60,000 thought it was a bad alternative. For both comparisons, the differences are statistically significant at the 0.10 level, not the 0.05 level.

25. There is one exception to this finding, but it is difficult to determine if it is meaningful, so it is included as an endnote. The 13 percent of respondents who declined to disclose their incomes on the survey were slightly more likely to say that an ISA was not a good option for them personally than those who reported their current household income. Eighty-five percent of those who declined to report their income said an ISA would not be a good option for them personally. Seventy-eight percent of those who reported their incomes answered that way. (This finding is statistically significant at the 0.10 level but not the 0.05 level.) It might make sense that this group of respondents did not like ISAs. ISA recipients make payments on a share of their income and would therefore have to *disclose* their income annually as part of the contract. If someone does not like reporting his or her income, then he or she probably will prefer a loan over an ISA. There could, of course, be other explanations for this pattern, but it is hard to determine with the existing data.

26. Student respondents were asked to select among three answers for the questions on type of school attended, including two-year community college (27 percent), four-year college (70 percent), or technical school (3 percent). The actual undergraduate population of dependent students, according to the US Department of Education National Postsecondary Student Aid Study 2011–12, is two-year college (35 percent), four-year college (59 percent), and for-profit school (6 percent).

27. Only students were asked what type of school they are attending or are planning on attending, limiting the sample size to that of 400 students. By extension, that also limited our ability to identify any differences within that group that might exist in the broader population.

28. The share of undergraduate students and parents of undergraduate students borrowing private and PLUS loans comes from the National Postsecondary Student Aid Study 2011–12. See US Department of Education, “National Postsecondary Student Aid Study,” <https://nces.ed.gov/surveys/npsas/>. Annual Parent PLUS volume is published by the Congressional Budget Office. See Congressional Budget Office, “CBO’s March 2016 Baseline Projections for the Student Loan Program,” www.cbo.gov/sites/default/files/recurringdata/51310-2016-03-studentloan.pdf. Estimates for private student loan volume come from Andrew P. Kelly and Kevin J. James, *Looking Backward or Looking Forward? Exploring the Private Student Loan Market*, American Enterprise Institute, June 1, 2016, <http://www.aei.org/publication/looking-backward-or-looking-forward-exploring-the-private-student-loan-market/>.

29. Parent PLUS loan interest rate is currently 6.31 percent with an additional 4.3 percent origination fee. If repaid over 10 years, the annualized percentage rate for these loans is approximately 9.5 percent.