



New Funding, Aligned Incentives

HOW PRIVATE FINANCING OPTIONS CAN
FOSTER HIGHER EDUCATION INNOVATION

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Executive Summary

The emergence in recent years of promising, non-traditional higher education programs—including competency-based education, workforce-oriented boot camps, and unbundled course providers—has led to a growing interest in ways to facilitate innovation in higher education. This interest has typically taken the form of proposals to provide taxpayer support for innovative new offerings. However, private financing options can also help achieve the same goal of a more dynamic and high-quality higher education system, especially given the risks associated with expanding access to taxpayer funding.

More specifically, the policy conversation on innovation has centered around ideas to create new pathways to federal-aid eligibility for nontraditional programs. After all, the fact that a program is innovative does not mean it is inexpensive, and because many nontraditional programs lack access to federal aid, their growth may be limited if potential students cannot cover the costs out-of-pocket. Furthermore, restricted access to financial aid may limit the types of students who can benefit from these programs, a significant shortcoming for those concerned with equal access to educational opportunities. At the same time, several researchers have raised the alarm at the potential for new pathways to become avenues for low-quality programs to expand via access to federal programs—harming both students and taxpayers.

A larger and more diverse market of private financing options for students could contribute significantly to innovation in the higher education system. This includes not only traditional private student loans but also income share agreements (ISAs), in which a student agrees to pay a fixed percentage of his or her after-school income for a set time period in exchange for funds to pay for school. Private funders bring

additional money to the table and have built-in incentives to ensure that a program actually lives up to its promise. Several private funders have also entered into risk-sharing arrangements with their institutional partners, helping to further align incentives among students, schools, and funders.

There are compelling examples of how private financing options are currently expanding the array of innovative offerings for students. A diverse set of startup lenders has arisen to help fund the expansion of new and seemingly high-quality boot camp programs, built around highly relevant workforce skills, as well as other innovative programs. On a more limited scale, some institutions and funders have begun using an ISA financing model to expand access and demonstrate a commitment to student success through risk-sharing. As a result, institutions and programs in these nontraditional spaces have been able to increase the number of students they serve.

These ideas and examples offer a road map for both institutions and policymakers interested in innovation. An institution considering a nontraditional program—that is, one that might not be eligible for federal aid—could look to other, potentially more nimble sources of financial aid in the private sector.

For their part, policymakers can take steps to foster a wider array of beneficial private financing options, which can in turn contribute innovation to the system as a whole. To accomplish this, policymakers should consider creating voluntary data systems for postsecondary programs interested in validating their student outcomes. Policymakers can also take steps to clear up several legal and regulatory issues, surrounding ISAs in particular but also affecting private student loans, which would help provide needed clarity for lenders and ISA providers.

New Funding, Aligned Incentives: How Private Financing Options Can Foster Higher Education Innovation

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

Few topics in higher education policy have sparked as much bipartisan interest as the need for innovation in higher education. Policymakers and researchers of all stripes have praised new models emerging in the postsecondary marketplace—ones that appear to offer students the ability to earn a credential more quickly, at a lower cost, and with greater confidence that their efforts will bear fruit after graduation. These models include nimble boot camp programs built around highly relevant workforce skills, competency-based education (CBE) programs designed to break free from the traditional credit hour, and unbundled online courses such as those offered by StraighterLine and other similar providers.¹

However, these new institutions and programs have been fairly limited in terms of scale. As a result, there is a lively debate about ways to expand their reach to more students, potentially through access to federal-aid programs.² After all, many innovative programs—while employing promising new delivery models—are still too expensive for many students to pay for out-of-pocket. For example, tuition for programs at General Assembly, a provider focused on short-term, highly relevant skills training, can range from close to \$10,000 to more than \$20,000 for programs lasting less than a year.³

Providing access to federal aid could therefore allow a much wider range of students—particularly low-income students—to benefit from these programs. At the same time, several researchers have expressed reservations about efforts to open federal programs in these ways out of fear that it could lead to

an expansion of low-quality programs or even diminish the incentives for existing high-quality actors to serve students well.⁴

While finding the right balance of access to federal-aid programs is important, reform-minded policymakers and institutional leaders interested in promoting innovation need not focus exclusively on expanding access to the federal purse. Expanding the universe of private financing options available to students is another way to foster innovation—and importantly, one that is free of many of the risks of taxpayer-funded approaches. In particular, private financing tools—including private student loans and income share agreements (ISAs), in which students pay a percentage of their income for a set time period—can bring additional funding to the table for these types of nontraditional programs.⁵ In addition, because private funders, rather than taxpayers, would be on the hook if the investments were low-quality, they would have a strong incentive to ensure potentially innovative programs are actually worthwhile.

This is not to say that policymakers should not continue to experiment with reforms designed to make federal-aid programs more conducive to innovation. Structured soundly, such proposals could potentially offer students a wider array of high-quality, lower-cost educational options.⁶ Rather, policymakers can take other steps *in parallel* with these efforts, which will help achieve the same goals. By not putting all their innovation eggs in the single basket of expanded access to taxpayer dollars, policymakers can be more conservative in their approach to those

reforms, helping protect against unintended consequences and abuse.

The paper is organized as follows: the first section elaborates more fully how private financing options could help foster innovation in higher education. The next section spotlights some areas in which private financing tools are helping to expand innovative programs, or at least offering a model of how they might do so in the future. The final section outlines several recommendations for policymakers seeking to maximize the value private financing has to offer in terms of an overall innovation agenda, as well as for institutions in need of financial-aid options for innovative programs not eligible for federal aid.

How Can Private Financing Options Foster Innovation?

Policymakers who wish to promote innovation through reforms to federal-aid programs are currently walking something of a tightrope. On the one hand, there are many proposals to create new pathways into federal-aid programs for nontraditional educational models.⁷ On the other, these efforts have raised concerns about the potential risk that low-quality institutions might take advantage of such pathways if oversight is too lax.⁸

While there are steps policymakers can take to mitigate these risks—such as establishing robust performance standards based on student outcomes or limiting such reforms to demonstration or pilot projects—these approaches have their own limitations. Robust performance standards can be difficult to implement effectively, particularly given data limitations, and pilot projects could severely restrict the number of students who could benefit from an innovation, potentially for years.

Can private financing options help promote the same goals? There are good reasons to think they could. To understand how, it first helps to define these options more specifically.

The most common is private student loans, in which a borrower receives money for school and subsequently is required to pay back the amount borrowed with interest through a series of fixed payments

over the course of the payment term. In this context, private loans include only loans made independently from the federal student loan program, without any federal subsidies or guarantees. The lender thus bears the full risk of nonrepayment or default. These loans currently constitute a small portion (roughly 8.7 percent) of the nearly \$96 billion in student loan dollars originated in the 2013–14 academic year.⁹

A newer type of private financing option is an ISA, a tool in which a student receives private financing in exchange for agreeing to pay a set percentage of his or her income for a set number of years after school. Unlike a traditional student loan, an ISA has no principal balance or interest rate—the student is simply agreeing to make payments tied to a percentage of his or her income over the payment term. As a result, he or she may pay back more than received initially, less than that amount, or potentially even nothing at all.

The purpose of this payment structure is to shift risk from the student to the funder, who is in a better position to hold and diversify that risk. In contrast, traditional student loans force the student to bear significant financial risk; a student is on the hook for both the principal and interest, regardless of whether his or her educational investment actually generates future earnings high enough to cover the debt obligation.¹⁰

ISAs are relatively new to the marketplace and therefore do not have any significant presence compared to traditional student loans, public or private. In the US, for example, the market consists of a small number of companies, nonprofits, and schools offering or planning to offer ISAs to students.¹¹

While distinct in important ways, both private loans and ISAs could bring about a greater variety of innovative educational institutions and programs. The most obvious way they can do so is simply by bringing additional funding to the table. In some cases, this additional funding could be helpful if federal aid falls short of covering the cost of an innovative program that is expensive but still yields benefits in excess of its costs. In other cases, however, a particular institution will not be eligible for federal-aid funds because it cannot—or chooses not to—meet the various requirements for federal-aid eligibility. Thus, private financing can fund promising programs

that have not gone through the hoops required to access federal-aid programs—without creating additional risk for taxpayers.

For similar reasons, private financing options can be more flexible in terms of the types of programs financed. Whereas policymakers are sometimes restricted to various types of pilot programs due to the potential risks to taxpayers, private lenders or ISA providers could seek out and fund innovative programs that policymakers and other observers had not even considered yet. In fact, the development of boot camp programs, occurring outside the scope of federal-aid programs, is a good example of a new innovation that most observers did not anticipate. Having private financing options that are more broadly accessible could help accelerate these kinds of disruptive innovations.

Just as important as bringing money to the table are the incentives funders face. This is another area where private financing has advantages over federal-aid programs. Because private funders bear the risk of loss if students they finance fare poorly in the labor market, they have stronger incentives to ensure that students are making worthwhile investments. In contrast, federal-aid dollars tend to be available at a wide array of institutions and programs, including many of dubious quality.¹² Furthermore, reform efforts to add additional accountability measures to federal-aid programs face a steep uphill climb, as policymakers and other stakeholders have difficulty agreeing on what those measures should look like—or whether they should be added at all—given concerns about ensuring access and the fact that federal-aid dollars are the lifeblood of many institutions.¹³

In addition to evaluating an institution's merit themselves, some private funders actually require that institutions bear some risk of loss when a student's education does not pan out. Skills Fund is one private lender using this approach, and as Rick O'Donnell, the company's founder and CEO, described it, "For every student we finance, we have a model in which if there are defaults of their students on a loan, those losses are first covered by funds from the school. The school has real skin in the game in terms of defaults."¹⁴

Risk-sharing models such as these help limit the potential losses a lender faces because, as O'Donnell put it, "when we align these incentives" with an institution, "it's more likely we'll have a strong student outcome."¹⁵ Such institutional risk-sharing arrangements could be particularly useful for innovative programs that have yet to prove their worth on any significant scale and thus are a bit unknown to students and funders.

At the same time, private lenders and ISA funders face different incentives. Consider private student loans: the lender is bearing a risk of loss if the student does poorly and is unable to meet his or her loan obligation. The lender thus has an incentive to ensure that loan dollars are effectively underwritten. However, the student is still ultimately on the hook for the entire balance, particularly given that private student loans have a very strict standard for bankruptcy discharge.¹⁶ This could weaken a lender's incentive to look carefully at the quality of the program a student is pursuing.

In contrast, with an ISA, a student's obligation varies with his or her income after school. There is no balance that the student is ultimately responsible for, and as a result a student could pay less than what he or she received—or potentially even nothing at all, in the case of a bad outcome. Therefore, the funder is bearing much more of the financial risk and may have stronger incentives to carefully evaluate a program's merit.

Furthermore, because in many cases a parent cosigns a student's private loan, the lender could be even less incentivized to underwrite the actual quality of the program the student is pursuing—seeing it more as a family loan rather than one made on the basis of the student's educational investment.¹⁷ In the 2014–15 academic year, roughly 93 percent of undergraduate private student loans were cosigned.¹⁸ In this case, the underwriting process—if chiefly built around a coborrower's credit history—may not always protect the student from low-quality programs.

To be sure, private loans can still play an important role in helping to vet nontraditional providers. However, they are better suited to this role when they adopt a forward-looking posture—one that explicitly

examines the quality of the investment the student is making—rather than relying largely on a cosigner. To this point, because a student’s payments under an ISA derive from his or her future income, ISA providers must evaluate students based on how they expect them to do after school, rather than on the credit-worthiness of a coborrower. This not only provides stronger incentives for funders to look at whether innovative programs are actually worth their salt, but it also ensures that students are well-protected from the risks of pursuing nontraditional offerings.

Fundamentally, private financing options, both private loans and ISAs, can play a valuable role in helping to foster innovation in American higher education. The next section looks at some examples of how these options are doing so currently or may do so in the future.

Where Is Private Finance Fostering Innovation?

The previous section spelled out why, in theory, private financing options can advance innovation in higher education. However, it is also helpful to look at cases in which they are already doing so, or at least offering a model of ways they might do so in the future. This section therefore highlights several examples, some involving private loans and others focused on ISAs, including additional qualitative feedback through a series of interviews with some of the institutions and funders involved.

Private Student Loans

The following examples highlight how private lenders have contributed to the development and expansion of a variety of innovative educational programs.

Skills Fund. A Texas-based company founded in late 2015, Skills Fund offers a compelling model as to how a private lender can help support innovative programs in higher education.¹⁹ Skills Fund develops partnerships with institutions that meet its quality-assurance standards—lending to just boot camps at the moment—and then offers financing to

students attending those institutions. As Skills Fund Founder Rick O’Donnell pointed out, the lender looks at a range of student outcomes such as completion rates, job-placement rates, employer engagement, graduate satisfaction with their program, the quality of the program’s curriculum, instructors and management, and the institution’s financial wherewithal.²⁰

In helping students attend some of the high-performing boot camps that have cropped up in recent years, Skills Fund is directly contributing to higher education innovation. In fact, in describing the company, O’Donnell used concepts that closely mirror the conversations taking place around innovation in Washington, arguing that “the original conception for Skills Fund was this analogy: colleges and universities need accreditation to get access to the federal purse, so let’s create an innovative quality-assurance body for innovative higher ed that has its own purse.”²¹ Said differently, Skills Fund can provide a means for students to finance these programs in which all parties’ interests are aligned—students, institutions, and funders—and in which taxpayers are not put at risk.

In addition, while Skills Fund’s current partners are all boot camps, that need not always be the case. As O’Donnell noted:

There are huge pockets of higher ed that are underserved from a financing perspective. It’s not just new innovative coding boot camps. Medical technology training schools have a hard time getting funding, as do business skills boot camps, digital media, digital arts, digital editing schools. Students attending postsecondary providers that are not traditional degree-granting institutions or old-fashioned vocational proprietary schools have a gap in financing.²²

In short, while still small—Skills Fund raised \$11.5 million in seed funding in late 2015—the lender has plans to finance a range of programs that meet its standards, not just boot camps.²³ Thus, over time Skills Fund could be a growing catalyst for innovation in many areas of higher education.

Climb Credit. Founded in 2014, Climb Credit is similar to Skills Fund in that it seeks out programs that meet a certain level of quality.²⁴ As Zander Rafael, the company's cofounder and CEO, described, "What we saw in the United States was a whole lot of high-quality, skill-based training programs struggling to find funding for students because many of those students had poor credit backgrounds."²⁵ However, he said, "If you could find the good programs, you could actually help the students change their lives by offering better financing." And as the company learns more about which programs are worthwhile, he noted, "We can share that, saying, 'you want to go to a school in this geography and you want to work in the following field, well here's what the best schools are—and by the way you're preapproved for a loan at any one of them.'"²⁶

While still relatively new, Climb Credit works with more than 70 campuses nationwide, financing a diverse array of programs. This includes boot camps, CBE programs, online learning, and a variety of skill-focused programs.²⁷ Rafael noted that the company's focus is on American higher education broadly, not just top-tier institutions. In terms of quality, distinguishing between an MIT program and an online criminal justice program at Corinthian Colleges is easy, he said, "but if I ask you to tell me the best competency-based training program for a nursing program, no one has any idea."²⁸ Lenders like Climb Credit, therefore, can help identify and grow programs that serve students with a wide variety of backgrounds, rather than just elite students or institutions.

Finally, as with Skills Fund, Climb Credit asks institutions to bear some of the risk of their students' outcomes, enabling them to offer financing to a larger fraction of students. "One of the things we do in order to [expand access to credit] is that we actually ask the schools to participate in some of the risk with us," Rafael said.²⁹ This arrangement helps ensure institutions have a strong incentive to consider their students' outcomes.

Minerva Schools, General Assembly, and Other Institutions. One important example of how private student loan options can foster innovation is

nontraditional institutions that are successfully growing without access to federal loans and grants. One such example is Minerva Schools, a fully accredited university that follows an intensive, seminar-based model of undergraduate education. Regarding financial aid, Ben Nelson, founder and CEO of Minerva, stated, "We have access to federal loans and grants but refuse to take the money," citing concerns that federal-aid programs can decrease an institution's incentive to contain its costs.³⁰

Instead, to help students afford tuition and other costs, Minerva has relied on a combination of controlling costs—tuition is \$10,000 per year—and non-governmental sources of funding, such as private student loans.³¹ Nelson pointed out that Minerva has been able to do this while maintaining a "completely need-blind admissions process."³² In terms of the private financing market though, Nelson noted that more options would absolutely be helpful, because three-quarters of his students depend on financial aid.

Another example is General Assembly (GA), an institution founded in 2011 that offers, according to its founder and CEO Jake Schwartz, "immersive, transformative skills training" focused on providing skills integral to labor market needs.³³ GA has served more than 25,000 students to date and operates in 15 cities across 5 countries.³⁴ Like Minerva's students, GA's students cannot use federal loans and grants to cover its tuition, which can run as high as \$20,000 or more.³⁵

That said, Schwartz noted that "our students have a lot of financial options. There are plenty of lenders who want to lend to our students, and we continue to evaluate additional options."³⁶ In general, Schwartz believes accountability for institutions is fundamental, and therefore funding options that lend against students' postgraduation workforce outcomes are far more effective because institutions are held accountable for whether their students can repay their obligations—a characteristic he emphasized is lacking in federal lending programs.

These two institutions are certainly not the only ones sustaining themselves and growing with private loan options. According to CourseReport, a website that follows the boot camp industry, Skills Fund and Climb Credit are just two examples of a robust group

of new private lenders serving the population of boot camp students. A survey of boot camp students found that for those who used an external lender, 21.5 percent used Climb Credit, the highest of any lender in the survey. However, students used a variety of other lenders as well, including Affirm (20 percent), Earnest (8.5 percent), Upstart (7.5 percent), and several smaller lenders.³⁷

Furthermore, as the boot camp industry has grown—serving around 16,000 students in 2015 compared to around 2,100 in 2013—the fraction of students relying on an external lender has grown as well. In 2013, only 3.7 percent of students took out a private loan to pay for their boot camp expenses.³⁸ In 2015, that number jumped to almost one in four (24.8 percent).³⁹ The existence of lenders willing to help students cover these programs' upfront costs—which are \$11,800 on average—has therefore contributed to the expansion of these innovative options for students.⁴⁰

Income Share Agreements

The following examples highlight how ISA providers have contributed to the development of innovative educational options and provide models of how they might do so in the future.

Lumni and Other ISA Providers. Lumni is a company that has financed more than 7,000 students using ISAs in four Latin American countries and in the US (under a pilot project).⁴¹ While many Lumni students attend traditional institutions, the company has financed students at nontraditional programs in Latin America, such as flight attendant training, mine equipment operation, and occupational safety courses.

Regarding innovative and nontraditional programs in the US, Miguel Palacios, a finance professor at Vanderbilt University and cofounder of Lumni, said that the company would certainly consider such programs.⁴² “If you consider successful programs,” he said, “programs with near universal completion rates and high starting salaries relative to their cost, then there would be no particular barrier to financing

them.”⁴³ Regarding boot camps in particular, he noted that “the fact that they are short and skill-focused suggests that they could be, actually, quite safe.”⁴⁴

Lumni is not currently offering ISAs in the US, partly due to legal and regulatory concerns (described further below).⁴⁵ That said, there is a budding industry of new firms looking to offer ISAs to US students. One example is Education Equity Inc., which has focused on teachers pursuing graduate education.⁴⁶ While all the students financed so far have been at traditional programs based within colleges of education, Andy Davis, the company's founder and CEO, said they have recently pursued nontraditional teacher preparation programs launched outside academia. “I don't think there's anything inherently more risky about them due to their not having the department's approval,” he noted, and “it seems like an obvious place to go look because of the fact that the federal option isn't there.”⁴⁷ Other newer entrants to the ISA market include Base Human Capital, Vemo Education, and FitBux.⁴⁸

App Academy and Other Institutions Using an Income-Share Model. Founded in 2012, App Academy is a coding boot camp offering 12-week courses in San Francisco and New York City.⁴⁹ As with many other boot camps, its graduates appear to be very successful in the labor market: the school reports that 98 percent get hired and earn an average salary of \$105,000 in San Francisco and \$89,000 in New York City.⁵⁰

What makes App Academy unique, however, is its tuition policy: students are not required to pay any tuition upfront. Instead, they pay a fraction of their first-year salary to compensate the boot camp. “This model really solves the problems of access to education because students don't have to pay a huge fee upfront,” Cofounder Kush Patel said. “I think it's greatly increased the number of folks that we can provide this education to.”⁵¹

In addition to providing capital, however, the tuition-deferment policy acts as a form of risk-sharing. To this point, Patel noted, “I think it makes the course much more appealing, especially without having a brand name like MIT or Berkeley. . . . We can show

that our product is valuable in a very real way. We're standing behind it with the ISA model."⁵²

Using an ISA financing model in lieu of charging tuition has not been without its challenges, though. "I wouldn't call it easy," Patel noted. "There is definitely legal uncertainty around the ISA model, so I think clarity on that would definitely help more schools to kind of adopt this approach."⁵³

App Academy is not the only institution to adopt this financing model. Viking Code School, an online coding boot camp, is another example.⁵⁴ Another is Holberton School of Engineering, a two-year higher education program for software and operations engineers that charges a percentage of graduates' earnings for three years after school, rather than charging tuition upfront.

Finally, in 2015, Purdue University announced its interest in piloting a new financial-aid option for its students, specifically allowing them to take ISAs as an alternative to private and Parent PLUS loans, which offer little protection against financial risk.⁵⁵ While innovation is not the primary intent of the Purdue program, this model is one that could easily be adapted for those purposes by, for example, offering financing for programs, such as CBE, that might not be eligible for federal aid.

Challenges and Recommendations

As shown in the previous section, private financing options are already playing some role in funding nontraditional higher education providers and programs. But there are steps that policymakers can take to address challenges that may limit the availability of these finance options and, commensurately, to make it easier for promising innovative programs to enter the market and serve more students. In addition, institutions considering experimenting with nontraditional models can look to some of the examples highlighted in this paper as ways to finance those offerings.

Policy makers

Policy makers should consider these two reforms as ways to foster additional private financing options

that could be conducive to innovation in higher education more broadly.

Create Voluntary Data Systems to Enable Transparent, Validated Institutional Outcomes.

While many boot camps appear to be very successful in helping students find employment in their respective fields, some observers have questioned the placement numbers these institutions advertise. For example, a recent *International Business Times* article argued that there are no common standards to determine how boot camps should calculate their outcomes, and in many cases, no independent third party has verified those outcomes.⁵⁶ Furthermore, the author notes that while the industry has attempted to organize an association dedicated to creating a common set of standards around outcomes reporting, the effort has stalled over disagreements regarding the formula for such calculations.

To help address these issues, policymakers can create voluntary mechanisms that drastically simplify the task of validating certain institutional outcomes, most notably after-school earnings. For example, some states now report earnings information for graduates of different institutions and programs within their state (aggregated to protect individual privacy).⁵⁷ Importantly, rather than relying on unreliable surveys of alumni, these states have connected wage information—often through public unemployment insurance databases—to postsecondary enrollment records. This creates a straightforward and administratively efficient mechanism for reporting reliable and independent information about the outcomes of different educational institutions while still ensuring the privacy of individual students is protected. Such data would likely help private lenders and ISA providers as they consider which institutions appear to be preparing students well for the workforce.

While built around traditional institutions, states could adapt these systems by enabling nontraditional programs to also have their outcomes reported publicly if desired. Specifically, institutions could have the option to submit enrollment records, ideally broken down by program. The state agency overseeing such a system could then match those records with

wage data in state databases, creating a summary of the earnings information for graduates of that institution's programs.

States could also construct similar systems, where possible, to report on the outcomes of state licensing processes and other relevant student outcomes that the state may already track through other administrative processes. As an additional benefit, states could provide for streamlined authorization processes—ones focused on student outcomes rather than institutional processes, as is the norm—for institutions willing to participate in such a system.⁵⁸ Over time, the federal government could also help track students who cross state lines or offer a similar service using federal data.

Provide Legal and Regulatory Clarity for ISAs and Private Student Loans.

While there are some promising examples of how ISAs could help foster innovation, the market for ISAs is still relatively new, limiting their potential benefits. To a certain degree, developing a more robust market may just take time.⁵⁹ However, as other researchers have mentioned, the lack of clarity in terms of the legal and regulatory treatment of ISA contracts—including how ISAs should be treated regarding taxes, consumer disclosure, bankruptcy, and other areas of regulation—appears to have significantly slowed the development of an ISA market for students.⁶⁰

By taking steps to resolve these questions, policymakers would provide entities offering ISAs confidence in their interpretation of the law and, even more importantly, ensure students have adequate protections against abuse.⁶¹ Establishing a clear operating environment for ISAs would thus make it more likely that a robust ISA market would develop, serving a wide array of students and institutions—and enhancing the potential benefits for innovation in higher education.⁶²

In a similar vein, regulatory uncertainty can also impede the development of private student lending options that could advance innovation in higher education. As mentioned earlier, private student loans are most helpful in this regard when lenders scrutinize the institutions and programs students are

pursuing rather than simply relying on a student's credit history. However, as discussed at length in a recent paper focused on private student loans, fair lending laws could potentially be slowing the development of these types of “forward-looking” private lending options.⁶³

Policymakers and researchers should therefore devote more attention to examining this question. If fair lending laws conflict with beneficial underwriting practices, lawmakers and regulators could seek ways to provide additional clarity to the market—potentially through safe harbors—without undermining the basic antidiscrimination goals that motivate these laws.

Institutions

Institutions wishing to bring in additional financial-aid dollars for innovative programs not eligible for federal aid should consider these options.

Consider Private Financing Options to Fund Innovative Models.

Many institutions are experimenting with different types of educational models, and in some cases, these new offerings are not eligible for federal financial aid. The most common example is CBE programs, of which there are now more than 300 at institutions nationwide.⁶⁴ While both the Department of Education and Congress are working on carving out space for these types of programs in federal-aid programs, representatives from a number of leading CBE institutions have cautioned against making federal aid generally available to CBE offerings until policymakers and practitioners have developed adequate policies for both ensuring quality and preserving space for innovation.⁶⁵ As a result, any new flexibilities could be limited to a relatively small number of programs in the near future.

Interested institutions, however, could partner with private lenders or ISA providers to offer financial aid to students in nontraditional programs. An institution could even follow a model that is closer to that used by App Academy if it wishes to just defer tuition entirely while having former students pay a flat percentage of after-school earnings, ensuring

their obligation will always remain affordable. These options would allow institutions to start experimental programs without relying solely on students who can pay out-of-pocket or waiting for a waiver or broader effort from Congress or the Department of Education. Furthermore, relying on private financing would likely offer students an additional degree of confidence that the program is worthwhile.

Consider Risk-Sharing Arrangements. Several newer, nontraditional lenders require that institutions they partner with retain some amount of risk of student default. As Rick O'Donnell of Skills Fund noted, this can help align the incentives between the student, the lender, and the institution—particularly in a market where many institutions may be relatively new and therefore lack lengthy track records.

Innovative programs and institutions that would benefit from additional financing sources should consider such a risk-sharing arrangement. This is in part because it reveals a confidence in the institution's outcomes; it is also because it may increase the number of lenders willing to finance the institution's students—providing students with greater choice and potentially better pricing on their loans as a result of greater competition for their business.

Concluding Remarks

Policymakers and institutional leaders are right to focus on the need for innovation in higher education. Institutions new and old are experimenting with promising new models that could offer students substantially better value for their educational dollar. And because high-value options are often not cheap, it is important to consider what financial-aid options are available so students of all backgrounds

can benefit from these encouraging innovations. In that same vein, access to financial aid will help institutions experimenting with new models grow to scale because students will have a mechanism to cover a program's costs at the time of enrollment.

But financial aid need not always mean government funding. Given the risks involved in allowing new actors into federal-aid programs, policymakers would be wise to proceed cautiously on that front while taking steps, in parallel, to grow the array of private financial-aid options available to students. In doing so, they can strike the right balance of expanding access to these potentially beneficial educational programs while ensuring students and taxpayers remain protected. And institutions exploring new types of programs, for their part, could potentially benefit from partnering with private funders to offer their students a new source of financial aid when federal-aid programs might not be available—ensuring a wide range of students have access to innovative new offerings.

About the Author

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Previous Papers in This Series

- **Students' Futures as Investments: The Promise and Challenges of Income-Share Agreements,** *Jon Marcus*

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Notes

1. For example, the White House held a symposium on higher education innovation on July 30, 2015. See Inside Higher Ed, “White House Summit on Short-Term Training Programs,” July 30, 2015, www.insidehighered.com/quicktakes/2015/07/30/white-house-summit-short-term-training-programs. The White House also launched a TechHire initiative, a “bold multisector effort to empower Americans with the skills they need to succeed in today’s economy,” including through engagement with “innovative nontraditional approaches like ‘coding bootcamps.’” See the White House, “Fact Sheet: President Obama Announces New Commitments from Investors, Companies, Universities, and Cities to Advance Inclusive Entrepreneurship at First-Ever White House Demo Day,” news release, August 4, 2015, www.whitehouse.gov/the-press-office/2015/08/04/fact-sheet-president-obama-announces-new-commitments-investors-companies. Another example is Rep. Virginia Foxx, chairwoman of the Subcommittee on Higher Education and Workforce Training for the US House Education and Workforce Committee, who wrote, “Washington should encourage more innovation, such as competency-based education, so students can earn a degree at a faster pace and lower cost.” See Virginia Foxx, “Rep. Virginia Foxx: The Student Loan Debt Solution Is All About Jobs,” Credit.com, September 9, 2014, <http://blog.credit.com/2014/09/rep-virginia-foxx-student-loans-95430/>. For more information on Straighterline, see Straighterline, “How Straighterline Courses Work,” www.straighterline.com/how-it-works/how-to-earn-college-credits/.

2. Paul Fain, “Emerging Path to Federal Aid,” Inside Higher Ed, April 9, 2015, www.insidehighered.com/news/2015/04/09/political-pressure-builds-new-accreditation-and-aid-pathway-upstart-providers.

3. Andrew P. Kelly and David A. DeSchryver, *Beyond Bootcamps: Policy Considerations for Accelerated Learning*, Whiteboard Advisors, March 31, 2015, https://ga-core.s3.amazonaws.com/cms/files/files/000/002/750/original/General_Assembly_Beyond_Bootcamps_Policy_Report.pdf.

4. Emily DeRuy, “Financial Aid Now Pays for Coding Bootcamps and MOOCs,” *The Atlantic*, October 14, 2015, www.theatlantic.com/politics/archive/2015/10/financial-aid-now-pays-for-coding-bootcamps-and-moocs/433116/.

5. For a longer discussion of ISAs, see Miguel Palacios, Tonio DeSorrento, and Andrew P. Kelly, *Investing in Value, Sharing Risk: Financing Higher Education Through Income Share Agreements*, American Enterprise Institute, February 2014, www.aei.org/wp-content/uploads/2014/02/-investing-in-value-sharing-in-risk-financing-higher-education-through-income-share-agreements_083548906610.pdf.

6. Andrew P. Kelly and Kevin James, *Untapped Potential: Making the Higher Education Market Work for Students and Taxpayers*, American Enterprise Institute, October 2014, www.aei.org/wp-content/uploads/2014/10/Untapped-Potential-corr.pdf.

7. In July 2014, for example, the House passed legislation to create a pilot program that would allow a certain number of CBE programs access to federal aid but without the credit hour constraints imposed on other programs. See Michael Stratford, “Baby Steps for Higher Ed Act,” Inside Higher Ed, July 24, 2014, www.insidehighered.com/news/2014/07/24/house-approves-bills-competency-based-education-college-information-site. Sens. Michael Bennet and Marco Rubio introduced legislation allowing for new “innovation authorizers” that could grant access to federal Pell Grants—bypassing traditional accreditation requirements—so long as a program could prove its value through predetermined measures of student outcomes. See Marco Rubio, “Rubio, Bennet Propose Accreditation Alternative to Higher Education Status Quo,” press release, September 30, 2015, www.rubio.senate.gov/public/index.cfm/press-releases?ID=oce236d4-d65a-497c-8b82-b84e424dcb27. Finally, in a similar vein, the Obama administration announced in late 2014 an experimental program to allow access to federal aid to a small number of partnerships between existing institutions, nontraditional providers, and a quality assurance entity. See US Department of Education, “Fact Sheet: Department of Education Launches the Educational Quality Through Innovative Partnerships (EQUIP) Experiment to Provide Low-Income Students with Access to New Models of Education and Training,” press release, October 14, 2015, www.ed.gov/news/press-releases/fact-sheet-department-education-launches-educational-quality-through-innovative-partnerships-equip-experiment-provide-low-income-students-access-new-models-education-and-training.

8. Robert Shireman, a senior fellow at the Century Foundation, made this point succinctly, arguing that “whenever you open the federal financing spigot in the education sector, you risk being flooded with low-quality programs run by charlatans.” See Robert Shireman, *How Not to Destroy Quality at Coding Boot Camps*, The Century Foundation, September 2, 2015, www.tcf.org/work/education/detail/how-not-to-destroy-quality-at-coding-boot-camps. Alexander Holt, a researcher at New America, argued that making federal aid

available to these new programs will “scuff” this “new, shiny object” just as it arrives on the higher education scene. See Alexander Holt, *Department of Education Will Scuff New, Shiny Object*, EdCentral, October 14, 2015, www.edcentral.org/exsitedfail/.

9. Author’s calculations based on data from Sandy Baum, Diane Cardenas Elliott, and Jennifer Ma, *Trends in Student Aid 2014*, College Board, 2014, <https://secure-media.collegeboard.org/digitalServices/misc/trends/2014-trends-student-aid-report-final.pdf>.

10. For more details on how ISAs transfer risk, see Palacios, DeSorrento, and Kelly, *Investing in Value, Sharing Risk*.

11. In other countries, such as several in Latin America, ISAs have been used more widely than the United States, but still on a relatively small scale. For example, Lumni, which operates in Chile, Columbia, Mexico, and Peru, has financed roughly 7,000 students. See Lumni, “About,” www.lumni.net/about/.

12. Andrea Fuller and Douglas Belkin, “Student Debt Payback Lags,” *Wall Street Journal*, September 13, 2015, www.wsj.com/articles/student-debt-payback-lags-1442189980.

13. The prolonged fight over the Obama administration’s ratings proposal is a good example of types of difficulties that accompany discussions about accountability. See Doug Lederman, Michael Stratford, and Scott Jaschik, “Rating (and Berating) the Ratings,” *Inside Higher Ed*, February 7, 2014, www.insidehighered.com/news/2014/02/07/colleges-and-analysts-respond-obama-ratings-proposal.

14. Rick O’Donnell (founder and CEO of Skills Fund), in discussion with the author, December 2, 2015.

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16. Student Loan Borrower Assistance, “Bankruptcy,” www.studentloanborrowerassistance.org/bankruptcy/.

17. For further discussion, see Andrew P. Kelly and Kevin J. James, *Looking Backward or Looking Forward? Exploring the Private Student Loan Market*, American Enterprise Institute, June 1, 2016, www.aei.org/publication/looking-backward-or-looking-forward-exploring-the-private-student-loan-market/.

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23. Colin Morris, “Skills Fund Just Raised \$11.5M to Fix Student Loans,” *Built in Austin*, October 21, 2015, www.builtinaustin.com/2015/10/21/115m-seed-round-skills-fund-offers-student-loans-actually-pay.

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25. Zander Rafael (cofounder and CEO, Climb Credit), in discussion with the author, March 9, 2016.

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33. Kelly and DeSchryver, *Beyond Bootcamps*.

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36. Jake Schwartz (CEO and cofounder, General Assembly), in discussion with the author, March 1, 2016.

37. Liz Eggleston, *2015 Coding Bootcamp Alumni Outcomes & Demographics Study*, Course Report, October 26, 2015, www.coursereport.com/reports/2015-coding-bootcamp-job-placement-demographics-report.

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