

MAKE IT SIMPLE, KEEP IT FAIR:

A Proposal to Streamline and
Improve Income-Driven Repayment
of Federal Student Loans

MAY 2017

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The Institute for College Access & Success (TICAS) is an independent, nonprofit, nonpartisan organization working to make higher education more available and affordable for people of all backgrounds. Our Project on Student Debt increases public understanding of rising student debt and the implications for our families, economy, and society. To learn more about TICAS, see ticas.org and follow us on Twitter at [@TICAS_org](https://twitter.com/TICAS_org).

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INTRODUCTION

Since Congress passed the first widely available plan in 2007, IDR has become an increasingly critical option for students who have to borrow to afford college, and it continues to have strong bipartisan support.

College has never been so necessary or so expensive for Americans. Rising costs, state disinvestment, declining household incomes, and grant aid that has not kept pace lead more students to borrow, and borrow more, to go to school. While federal student loans are the safest option for students who need to borrow, rising student loan debt has repercussions for both individuals and the broader economy. In addition to the severe consequences for those who default, student loan debt – even low debt when paired with low earnings – can hold borrowers back from starting a family, buying a home, saving for retirement, starting a business or farm, or saving for their own children’s education.

While not a solution for rising costs or debt, income-driven repayment (IDR) for federal student loans gained broad support over a decade ago from lenders, students, schools, and both Republicans and Democrats.¹ Since Congress passed the first widely available plan in 2007, IDR has become an increasingly critical option for students who have to borrow to afford college, and it continues to have strong bipartisan support.² IDR plans now help millions of borrowers stay on top of their loans and avoid default, providing the assurance of manageable monthly payments tied to their income and family size, as well as a light at the end of the tunnel so that student loan payments do not last the rest of their lives. In addition to providing repayment relief to borrowers struggling with low incomes relative to their debt, the availability of more affordable payments through IDR can help allay well-documented fears about college costs and debt that keep some students from ever attempting college and push others to drop out before completing.

However, the range of IDR plans available today – five of them, each with varying eligibility requirements, costs, and benefits – is confusing and contributes to under-enrollment among the borrowers who may need IDR the most. To better serve both borrowers and taxpayers, IDR must be both streamlined and improved. Needed improvements include simplifying the annual income recertification process in IDR, better targeting the benefits of IDR, and preventing forgiven debt in IDR from being treated as taxable income.

This report details a proposal to streamline the multiple IDR plans into one improved plan that caps monthly payments at 10% of income, provides tax-free loan forgiveness after 20 years of payments, targets benefits to borrowers who need help the most, and prevents borrowers with high incomes and high debt from receiving loan forgiveness when they could have afforded to pay more.

¹ For more information about the Plan for Fair Loan Payments and support for its goals, see <http://bit.ly/2p6ZF0I>.

² See, for example, Dynamic Repayment Act of 2017 (S. 799), introduced March 31, 2017, <http://bit.ly/2pL9Urx>; ExCEL Act of 2015 (H.R. 3752), introduced October 9, 2015, <http://bit.ly/1hD1hcM>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://bit.ly/2otSpLi>.

IDR IS A CRITICAL SAFEGUARD FOR BORROWERS BUT IMPROVEMENTS ARE NEEDED

As the costs students are required to cover outpace family incomes and available grant aid, Americans must increasingly rely on borrowing to get to and through college. Seven in 10 college seniors attending public and private nonprofit colleges graduated with debt in 2015, owing an average of \$30,100.³ The reality is even starker for low-income students: nine out of 10 borrow to finish a BA, and they graduate owing \$4,750 more on average than their higher income peers.⁴

Federal student loans are the safest and most affordable option for students who could not otherwise afford to go to college. Federal loans also enable students to attend full time, which makes them more likely to complete their programs.⁵ While college pays off for most borrowers, it does not for everyone, particularly those unable to complete their programs and students who attend colleges that overcharge and underdeliver. For borrowers who default on their loans, the consequences are severe and long lasting. Ruined credit makes it difficult to buy a car or rent an apartment, and can limit one's ability to get hired. A defaulted borrower may also face garnished wages, seized income tax refunds, and reduced Social Security checks. Unaffordable loan payments act as a drag not only on the financial health and futures of individual borrowers, but also on the economy as a whole. Stretching to make high monthly payments can mean forgoing or delaying getting married, having children, buying a home, saving for retirement, starting a business, or saving for one's children's education.

There are currently more than six million borrowers repaying their federal student loans in an IDR plan.⁶ Many of these borrowers will repay their loans in full, and many will *pay more* interest in IDR than under other plans, but do so through lower monthly payments over a longer period of time. IDR provides real relief for individuals and families struggling with high monthly loan payments relative to their incomes. In 2016, the average income of borrowers enrolled in the IBR, PAYE, and REPAYE plans was less than \$36,000 for an average household size of more than two people.⁷ And data show that borrowers in IDR are much less likely to default than borrowers in other plans.⁸

Although IDR is already helping millions of borrowers, there is broad and bipartisan consensus that it needs to be simplified and improved. For example, a record 8.4 million borrowers are currently in default,⁹ suggesting that many who would benefit from IDR are not yet enrolled. In addition to streamlining today's multiple IDR plans (detailed in Figure 1 below) into one plan, specific changes are needed to improve the annual income recertification process, better target IDR benefits, and prevent debt forgiven through IDR from being treated as taxable income.

Although IDR is already helping millions of borrowers, there is broad and bipartisan consensus that it needs to be simplified and improved.

³ TICAS. 2016. *Student Debt and the Class of 2015*. http://ticas.org/sites/default/files/pub_files/classof2015.pdf.

⁴ Calculations by TICAS using data from the U.S. Department of Education, National Postsecondary Student Aid Study, 2011-12.

⁵ See, for example, Center for Community College Student Engagement. 2017. *Even One Semester: Full-Time Enrollment and Student Success*. http://www.ccsse.org/docs/Even_One_Semester.pdf. See also National Student Clearinghouse Research Center. 2016. *Completing College: A National View of Student Attainment Rates - Fall 2010 Cohort*. <http://bit.ly/2oC5Asx>.

⁶ U.S. Department of Education. March 9, 2017. Electronic Announcement. "Federal Student Aid Posts Updated Reports to FSA Data Center." <http://bit.ly/2oC1Nvu>.

⁷ U.S. Department of Education. 2016 Federal Student Aid Training Conference. "Income-Driven Repayment (IDR) Plans / Pay As You Earn (PAYE)." <http://bit.ly/2pTArCK>. Slide 19.

⁸ Mueller, Holger M. and Constantine Yannelis. 2017. *Students in Distress: Labor Market Shocks, Student Loan Default, and Federal Insurance Programs*. NBER Working Paper No. 23284. <http://www.nber.org/papers/w23284>. U.S. Government Accountability Office. 2015. *Federal Student Loans: Education Could Do More to Help Ensure Borrowers are Aware of Repayment and Forgiveness Options*. <http://www.gao.gov/assets/680/672136.pdf>.

⁹ Calculations by TICAS using data from the U.S. Department of Education, Federal Student Aid Data Center, "Portfolio by Loan Status (DL, FFEL, ED-Held FFEL, ED-Owned)," <http://bit.ly/1O6zgrW>. Accessed March 9, 2017. Figures represent Direct Loan and FFEL borrowers whose loans are more than 360 days delinquent, and borrowers who defaulted on both a Direct and FFEL Loan are counted more than once.

FIGURE 1: SUMMARY OF INCOME-DRIVEN REPAYMENT PLANS¹⁰

REPAYMENT PLAN	ELIGIBILITY	MONTHLY PAYMENT	FORGIVENESS AFTER
Revised Pay As You Earn (REPAYE)	All Direct student loan borrowers. ^a No partial financial hardship (PFH) requirement ^b	10% of discretionary income ^c	20 years if repaying only undergraduate debt; 25 years if repaying any graduate debt
Income-Based Repayment (2014 IBR)	Borrowers who took out their first federal student loan on or after July 1, 2014, and have a PFH	10% of discretionary income, up to the fixed 10-year payment amount	20 years
Pay As You Earn (PAYE)	Direct student loan borrowers ^a who took out their first loan after September 30, 2007 and at least one loan after September 30, 2011, and have a PFH	10% of discretionary income, up to the fixed 10-year payment amount	20 years
Income-Based Repayment (Original IBR)	All federal student loan borrowers (Direct or FFEL) with a PFH	15% of discretionary income, up to the fixed 10-year payment amount	25 years
Income-Contingent Repayment (ICR)	All Direct Loan borrowers. ^d No PFH requirement	The lesser of: 20% of discretionary income and 12-year repayment amount x income percentage factor	25 years

^a Borrowers may be able to consolidate their FFEL and Perkins loans into a Direct Consolidation Loan to repay them in REPAYE, PAYE, or ICR. More information about the pros and cons of consolidation is available at <http://StudentAid.gov/consolidation>.

^b Borrowers have a “partial financial hardship” (PFH) if their calculated payment based on income and family size is less than what they would pay under the fixed 10-year repayment plan.

^c For all of these plans, monthly payments can be as low as \$0. For REPAYE, 2014 IBR, PAYE, and Original IBR, discretionary income is defined as the amount of adjusted gross income (AGI) above 150% of the poverty level for the borrower’s household size. For ICR, discretionary income is defined as the amount of AGI above 100% of the poverty level for the borrower’s household size.

^d Parent PLUS loans can be repaid in ICR if consolidated into a Direct Consolidation Loan.

Data from the Department of Education show that over half of borrowers enrolled in IDR missed their annual deadline to update their income information (a process called “recertification”),¹¹ which can lead to unaffordable spikes in monthly payment amounts, as well as interest capitalization that can add substantial costs. Strong bipartisan support for automating the annual recertification process shows broad recognition of the importance of solving this problem. Additionally, ongoing concerns about potential unintended loan forgiveness for high-debt, high-income borrowers continue to illustrate the need to better target the benefits of IDR to those borrowers who need help the most. Meanwhile, borrowers who do receive forgiveness of remaining debt after 20 or 25 years of responsible payments may face an unaffordable tax liability, because debt forgiven through IDR is treated as taxable income under current law. Concern about this tax liability, heightened by rapidly ballooning loan balances when borrowers earn so little that their monthly payments do not fully cover interest charges, may also discourage struggling borrowers from enrolling in IDR.

¹⁰ These plans are only available for federal loans that are not in default. For more information about these plans, see the Department of Education’s website, StudentAid.gov/IDR.

¹¹ U.S. Department of Education. “Sample Data on IDR Recertification Rates for ED-Held Loans.” Shared on April 1, 2015 at the second negotiated rulemaking session. <http://bit.ly/2pTKFDl>.

OUR PROPOSAL: A SIMPLE CHOICE FOR BORROWERS

There is broad, bipartisan agreement about the need to streamline and improve IDR, including proposals from multiple policy organizations, members of both parties in the House and Senate, and President Trump.¹² However, there is not yet consensus on how it should be done. Most proposals to date streamline the current multiple plans into one plan that is available for all borrowers to choose, and some of them contain a number of the recommendations outlined below. But some proposals would make IDR the only way to repay, an approach that could increase costs for borrowers and have other unintended consequences for college costs and debt (see discussion on page 7).¹³ Other proposed changes would significantly reduce IDR's effectiveness at keeping borrowers out of delinquency and default, such as requiring larger monthly payments, or undermine borrowers' ability to ever move on with their lives by extending the repayment period or eliminating loan forgiveness altogether.

We propose that all federal student loan borrowers be able to make a clear choice between two repayment options:

One fixed payment plan that would:

- Be available to all federal loan borrowers;
- Base the length of the repayment period on the total amount borrowed, so larger debts are repaid in more than 10 years; and
- Make monthly payments consistent and predictable throughout the life of the loan.

One improved IDR plan that would:

- Be available to all federal loan borrowers, regardless of their debt or income level, whether their loans are Direct or Federal Family Education Loan (FFEL), or when they borrowed;
- Ensure payments never exceed 10% of taxable income;
- Forgive any remaining debt after 20 years of payments;
- Better target benefits to those who need help the most and prevent borrowers with high incomes and high debt from receiving loan forgiveness when they could have afforded to pay more;
- Restrain ballooning balances for borrowers with low incomes relative to their debt;
- Make it easy for borrowers to keep their income information up to date; and
- Prevent the taxation of forgiven debt.

¹² See, for example, Dynamic Repayment Act of 2017 (S. 799), introduced March 31, 2017, <http://bit.ly/2pL9Urx>; ExCEL Act of 2015 (H.R. 3752), introduced October 9, 2015, <http://bit.ly/1hD1hcM>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://bit.ly/2otSpLi>. See also CNN, October 13, 2016. "Video: Donald Trump lays out student debt policy." <http://cnn.it/2otKjC7>. TICAS, December 16, 2016. Letter to then-President-elect Donald Trump and his transition team. "Recommendations to improve college affordability and success." <http://bit.ly/2pTKdF2>.

¹³ TICAS. 2014. *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges*. <http://bit.ly/1vcNmQX>.

It is important to retain borrower choice between a fixed payment plan and an income-driven plan. Some borrowers prefer the consistency of making the same monthly payment throughout the life of their loan without needing to regularly submit income documentation, or can afford to repay over a shorter time to minimize interest charges. Additionally, there are borrowers for whom IDR payments may prove unaffordable because of private education loan payments, medical payments, or other expenses that are not factored into the IDR payment calculation.

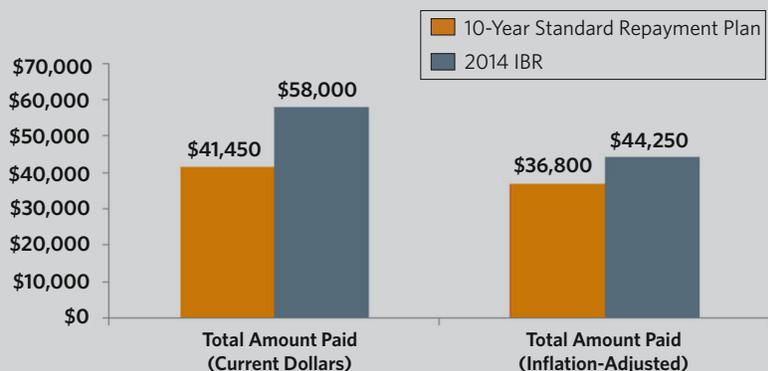
TRADE-OFF: LOWER MONTHLY PAYMENTS IN IDR MAY MEAN PAYING MORE, FOR LONGER

Making lower payments over a longer time can cost borrowers more in total due to accrued interest. In fact, a borrower can receive loan forgiveness in an IDR plan and still pay more in total than she would have under a different repayment plan. While loan forgiveness amounts are sometimes discussed as a dollar-for-dollar cost to the government (and a corresponding benefit for the borrower), this is not necessarily the case. The cost of federal student loans is more accurately determined by comparing how much the government lends with the total amount borrowers pay back over time plus the cost of administering the program. As the Government Accountability Office (GAO) recognized in a report last year, “[I]t is possible for the government still to generate income on loans with principal forgiven, particularly if borrower interest payments exceed forgiveness amounts.”¹⁴

For example, consider a borrower with \$30,000 in federal loans and \$35,000 income in her first year out of school. She would pay \$16,550 more in total under the 2014 IBR plan than in a 10-year fixed repayment plan (\$58,000 versus \$41,450), even though she would receive almost \$5,000 in forgiveness under 2014 IBR. For more detail about this and other borrower examples in this paper, see Appendix.

Figure 2: Borrower pays more in total under IDR than in the standard 10-year plan

HIGHER TOTAL PAYMENTS UNDER IDR THAN STANDARD 10-YEAR PLAN (Single borrower, \$30,000 debt, \$35,000 AGI)



This is an important trade-off to consider both for borrowers who must weigh the costs and benefits of enrolling in a fixed payment plan vs. an income-driven plan, and for policymakers weighing changes to program design and benefits.

¹⁴ TICAS. December 9, 2016. Blog Post. “What looking at forgiven debt doesn’t tell us about the costs of income-driven repayment and federal student loans.” <http://bit.ly/2pqTess>.

AVAILABLE TO ALL FEDERAL LOAN BORROWERS

To reduce complexity and to ease borrower communication and program administration, IDR should be available to all federal loan borrowers, regardless of their debt or income level, whether their loans are Direct or FFEL, or when they borrowed. Borrowers who want the assurance of having their loan payments tied to their income should be able to enroll in IDR whenever it makes sense for them, whether it is before they make their first payment, after they have hit a rough patch, or when they are concerned about what the future will bring.

Some of the current IDR plans require borrowers to meet a specific debt-to-income threshold (demonstrating a “partial financial hardship”, or PFH) in order to enroll. Eliminating this requirement greatly simplifies repayment plan selection, because borrowers do not have to first understand or satisfy a technical debt-to-income calculation. It also simplifies the servicing process by eliminating the loan servicer’s need to calculate and track the borrower’s PFH status, and simplifies communication and outreach efforts by removing the need to explain the PFH requirements that prevent some borrowers from qualifying for certain IDR plans.¹⁵ For these reasons, *the existing REPAYE plan and House and Senate bipartisan legislative proposals do not have a PFH requirement.*¹⁶

Additionally, borrowers should be able to enter IDR regardless of when they borrowed or whether they have a federal Direct or FFEL loan. To qualify for some existing IDR plans, borrowers must have taken out their first loan after a certain date, and that date varies between plans. These “new borrower” requirements are unnecessarily complicated and confusing. Also, several of the existing IDR plans are available for Direct Loans only, so borrowers wanting to repay FFEL loans in those plans have to go through the extra step of consolidating into a Direct Loan first.¹⁷

¹⁵ For more information, see TICAS. 2015. *Memo on Pay As You Earn Recommendations for Upcoming Negotiated Rulemaking Process*. http://www.ticas.org/pub_view.php?idx=975.

¹⁶ Dynamic Repayment Act of 2017 (S. 799), introduced March 31, 2017, <http://bit.ly/2pL9Urx>; ExCEL Act (H.R. 3752), introduced October 9, 2015, <http://bit.ly/1hD1hcM>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://bit.ly/2otSpLj>. For more information about REPAYE and the other existing IDR plans, see the Department of Education’s website, StudentAid.gov/IDR.

¹⁷ Additionally, under current rules, borrowers who started repaying their FFEL Loans in the Original IBR plan before consolidating them into a Direct Consolidation Loan would not be able to retain their qualifying payments from IBR in another IDR plan. As discussed on page 20, we recommend that all qualifying payments – made before or after consolidation – be counted toward loan forgiveness in IDR.

IDR ISN'T THE BEST PLAN FOR EVERYONE

Some have proposed making income-driven repayment (IDR) the default or only repayment plan available to federal student loan borrowers. While this would simplify the repayment plan selection process, there are important trade-offs for borrowers and other stakeholders to consider. Borrowers in IDR may pay more in total over the life of their loans than under other repayment plans, and carrying outstanding debt over a longer period of time may lead them to delay or forgo buying a home or making other financial commitments. Mandatory IDR could also reduce pressures on government and colleges to make higher education more affordable, leading to even higher tuition and less need-based grant aid. Additionally, greatly expanded participation in IDR could inadvertently create a safe haven for schools that fail to serve students well by resulting in lower Cohort Default Rates (CDRs) for colleges *for reasons unrelated to how well any college is serving its students*. For a detailed discussion of these trade-offs, see our 2014 paper, *Should All Student Loan Payments Be Income-Driven? Trade-Offs and Challenges*.¹⁸

Several countries have implemented some form of a mandatory IDR system for student loans. We looked closely at models in two countries: Australia and the United Kingdom. Ultimately, we found that significant differences in the size, heterogeneity, and tuition-setting mechanisms of each country's higher education system, as well as in their tax systems, social welfare policies, and other factors, mean that applying international lessons to the United States is not as simple as it seems and may lead to unintended and harmful consequences for borrowers. Additionally, we found that despite mandatory IDR, both Australia and the United Kingdom have continued to wrestle with the costs and benefits of their student loan systems, making changes over time that have increasingly shifted costs from the public to the student.

MONTHLY PAYMENTS NEVER EXCEED 10% OF INCOME

To help ensure that monthly student loan payments are a manageable share of a borrower's income and do not compete with essential needs, monthly payments for low- and moderate-income borrowers in IDR should be capped at 10% of discretionary income. This is the formula used in most IDR plans today, where "discretionary income" is calculated as a borrower's adjusted gross income (AGI) minus an "income exclusion." To better target the program, we propose phasing out the income exclusion for high-income borrowers (detailed further on pages 15 to 16), for whom monthly payments will still never exceed 10% of total income.

It is essential that the income exclusion be retained in the monthly payment calculation for low- and moderate-income borrowers in IDR. Current IDR plans all recognize that borrowers need to cover basic necessities like housing, food, and transportation before being able to make payments toward their student loans. This "income exclusion" is critical for ensuring affordable payments for struggling borrowers, affecting both the income at which borrowers are required to start making student loan payments as well as the calculation of their monthly payments. Without this income exclusion, for exam-

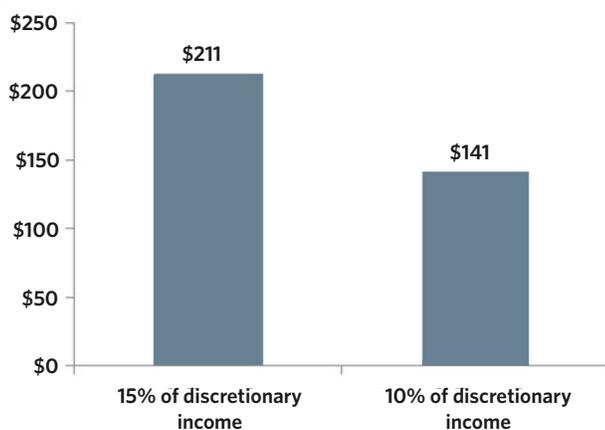
¹⁸ TICAS. 2014. *Should All Student Loan Payments Be Income-Driven? Trade-Offs and Challenges*. <http://bit.ly/1vcNmQX>.

ple, monthly payments would be *more than ten times higher* for borrowers with incomes of \$20,000 (\$16/month compared to \$167/month).¹⁹ Currently set at 150% of the federal poverty level for the borrower’s household size (\$18,090 for a single borrower in 2017), the income exclusion for most IDR plans in the U.S. is already much lower than the thresholds used in similar repayment systems in the United Kingdom (\$26,880) and Australia (\$41,152).²⁰

Beyond the income exclusion, any proposal to increase the maximum share of income borrowers are required to pay in IDR would also lead to significant increases in monthly payment amounts. For example, for a borrower with \$30,000 debt and an income of \$35,000, her monthly payment would be \$70 higher if calculated as 15% of her discretionary income rather than 10%.²¹ If she could afford the higher payments, she would end up paying less in total under a 15% plan because she would pay off her loans faster. But for those who could not afford the higher monthly bill, the goals of manageable payments and default prevention would be undermined.

Figure 3: Borrower pays more per month under a 15% IDR plan than 10% IDR plan

MONTHLY IDR PAYMENTS HIGHER UNDER 15% PLAN THAN 10% PLAN
(Single borrower, \$30,000 debt, \$35,000 AGI)



¹⁹ For more detail about this calculation, see Appendix.

²⁰ U.S. Department of Education. *Income-Driven Repayment Plans: Questions and Answers*. <http://bit.ly/1OD0oP6>. U.S. Department of Health and Human Services. “HHS Poverty Guidelines for 2017.” <https://aspe.hhs.gov/poverty-guide-lines>. Australian Government. Study Assist website. “Loan Repayment.” <http://bit.ly/1bleyxw>. U.K. Government. “Repaying your student loan.” <https://www.gov.uk/repaying-your-student-loan>. All conversions to U.S. dollars use the exchange rate from April 21, 2017 (1 British Pound equals 1.28 U.S. Dollars; 1 Australian Dollar equals 0.75 U.S. Dollars).

²¹ For more detail about this borrower example, see Appendix.

POTENTIAL HARMS OF PAYCHECK WITHHOLDING FOR STUDENT LOAN PAYMENTS

Sometimes paired with proposals to automatically enroll all borrowers in IDR is the recommendation to collect student loan payments via a paycheck withholding system. Automatic paycheck withholding of student loan payments raises multiple serious concerns. For example, such a policy prioritizes repayment of student debt above food, housing, medical care, and other expenses. It could also create burdensome complications for employers, privacy concerns for borrowers who do not want to share information about their student loan debt on the job, and difficulties for borrowers who are employed in untraditional ways (as detailed in Figure 4). There is currently a high bar for the types of expenses that can be forcibly (or even by default) withheld from Americans' paychecks, and routine student loan payments should not effectively become wage garnishments. Borrowers can already make automatic payments directly to their lender via their own bank accounts.

While paycheck withholding for student loans has been implemented in other countries, those countries differ from the U.S. in important ways, including their tax filing systems (e.g., whether spouses can file jointly or are required to file separately) and their social policies (e.g., the amount of health care expenses that individuals may have to shoulder).²²

Figure 4: If a borrower's employment is not simple, neither is paycheck withholding

PAYCHECK-BASED REPAYMENT MIGHT SIMPLIFY THE PROCESS FOR BORROWERS IN THESE CIRCUMSTANCES...	BUT MIGHT BE COMPLICATED FOR BORROWERS IN CIRCUMSTANCES LIKE THESE...
<ul style="list-style-type: none"> • Employed full time • Has only one employer • Works year round • Files taxes as single or married filing separately • Has money on hand to cover "lumpy" costs (e.g., car repair, rent deposit, hospital bill) 	<ul style="list-style-type: none"> • Employed part time • Works multiple jobs in a year • Works at a seasonal job • Self-employed • Files taxes jointly • Not enough left after monthly bills to cover "lumpy" costs

Additionally, there are logistical challenges to implementing paycheck withholding for student loan payments that would undermine the ultimate goal of IDR simplification.²³ For example, it would be necessary to determine:

- How to reconcile overpayments and underpayments, and what penalties are appropriate for underpayments.
- How to collect payments from borrowers who are out of the country for prolonged periods.
- How to account for borrowers who earn income outside of a payroll system. This is

²² For more information, see TICAS. 2014. *Should All Student Loan Plans Be Income-Driven? Trade-Offs and Challenges*. <http://bit.ly/1vcNmQX>.

²³ New America, Young Invincibles, and the National Association of Student Financial Aid Administrators. 2015. *Promise and Compromise: A Closer Look at Payroll Withholding for Federal Student Loans*. <http://bit.ly/1MxWdoM>.

not just borrowers who are self-employed; borrowers with employers may also earn income from investments or other sources.

- How to account for borrowers with spouses who earn income but do not have student loans.
- How to hold employers accountable for sending the correct payments, on time.
- How borrowers would be able to correct and protect their payment records and credit reports if a withheld payment were dropped, late, or incorrect.
- How to allow borrowers to continue to be able to request deferments or forbearances, e.g., if unexpected expenses arise and borrowers are no longer able to withhold their student loan payments from their paychecks.
- How borrowers would be able to raise defenses against their student debt. Automatic withholdings assume that people actually owe an outstanding debt and the right debt amount, but this will not always be the case.

FORGIVENESS AFTER 20 YEARS OF PAYMENTS

Many borrowers in IDR will repay their loans in full before 20 years, as illustrated in Figure 5 below. Capping loan repayment at 20 years provides necessary relief for those borrowers whose incomes are so low relative to their debt that they are unable to fully repay their loans even after *two decades* of monthly payments. *Twenty years is long enough to have to repay your student debt.*

Figure 5: Borrowers in IDR plans will repay in full (including all interest) if they:

BORROWED IN FEDERAL STUDENT LOANS:	AND EARN AT LEAST:*		
	ORIGINAL IBR (15%, 25 YEARS)	2014 IBR, PAYE (10%, 20 YEARS)	REPAYE (10%, 20 OR 25 YEARS)
\$30,000**	\$26,800	\$36,250	\$35,850
\$100,000	\$53,200	\$83,200	\$70,900

* Incomes are adjusted gross incomes (AGI) in current dollars, rounded up to the nearest \$50. Calculations assume a single borrower without dependents, and that AGI increases 4% a year. The \$30,000 debt is assumed to be from undergraduate study only, while the \$100,000 debt includes loans from graduate school. For more detail about these calculations, see Appendix.

** The average debt of 2015 bachelor's degree recipients who borrowed to attend public and private nonprofit colleges was \$30,100. For more information, see TICAS. 2016. *Student Debt and the Class of 2015*. http://ticas.org/sites/default/files/pub_files/classof2015.pdf.

Extending the repayment period for borrowers in IDR disproportionately harms the lowest income students. Students with high enough earnings would not be affected by an extension of the maximum repayment period because they would be able to repay their loans in less than 20 years. It is the students with continued low earnings relative

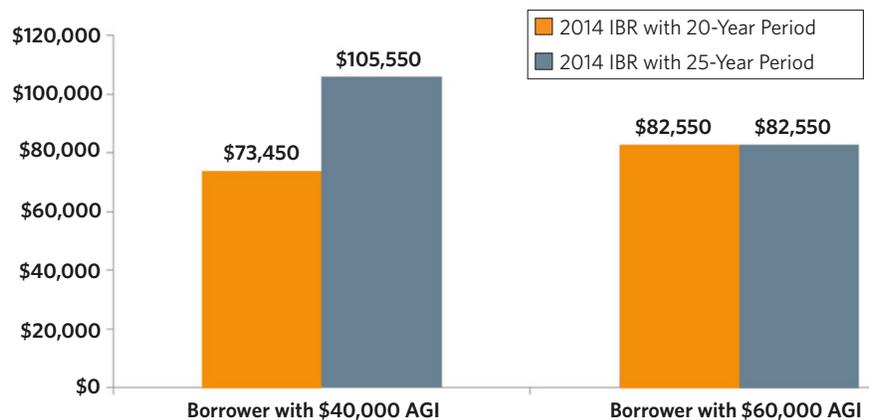
to their debt who would pay the price of making additional years of payments. It may also have severe repercussions on their ability to save for retirement or buy a home.

For example, the existing REPAYE plan requires borrowers with any loans from graduate school to make 25 years of payments on all of their loans before any remaining debt is forgiven, while borrowers with only undergraduate debt are eligible for forgiveness after 20 years. Some legislative proposals take a similar approach, extending the repayment period for students who borrowed more than the maximum amount allowed for undergraduates.²⁴

Consider two borrowers who both have \$50,000 in debt.²⁵ The first borrower earns \$40,000 while the second earns \$60,000. As shown in Figure 6, extending the lower income borrower's maximum repayment period to 25 years increases the total amount paid on his loans by about \$32,000, or 44%. In contrast, extending the repayment period would not affect the total paid by the higher income borrower. She is able to fully repay her loans in less than 15 years, so it doesn't matter whether her maximum repayment period is 20 years or 25 years.

Figure 6: Lower income borrower harmed by extension of repayment period, while higher income borrower is unaffected

EXTENDING IDR REPAYMENT PERIOD HURTS LOWER INCOME BORROWERS
(Total payments in current dollars, for single borrowers with \$50,000 debt)



²⁴ Dynamic Repayment Act of 2017 (S. 799), introduced March 31, 2017, <http://bit.ly/2pL9Urx>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://bit.ly/2otSpLi>.

²⁵ For more detail about these borrower examples, see Appendix.

Forcing borrowers to make payments for longer than 20 years has significant consequences. Beyond increasing the overall cost of borrowing, research has shown that carrying outstanding student debt may affect borrowers' ability and willingness to make other financial commitments, such as buying a home or a car, opening a small business, saving for their children's education, or saving for their own retirement.²⁶ Student debt can affect borrowers' access to other credit, and the need to set aside money for student loan payments ties up funds that could have been used in other ways.²⁷ Capping loan repayment periods at 20 years would help borrowers focus on saving for retirement and their children's education before the next generation is in college. Recent reports from GAO and the CFPB both found that the number of older Americans with student debt has increased sharply, and that their loans are more likely to be in default.²⁸ The CFPB found that almost 40% of borrowers over the age of 65 were in default compared to only 17% of borrowers under the age of 50. Delaying forgiveness beyond 20 years would make this problem even worse.

Twenty years is long enough to have to repay your student debt.

There are much fairer and more targeted ways to prevent borrowers with high incomes and high levels of debt from receiving loan forgiveness when they could have afforded to pay more. Instead of extending the repayment period for all borrowers or for borrowers with debt from graduate school, we propose better targeting the benefits of IDR in three key ways (see pages 14 to 17).

DEBT FORGIVEN IN IDR MUST NOT BE SUBJECT TO TAXATION

As discussed above, many borrowers will repay their full debt plus all accumulated interest before their repayment period is up, but borrowers who still have any remaining debt to forgive may face an unaffordable tax liability. Under current law, debt forgiven through IDR is treated as taxable income. Concern about this potential tax liability, which could run to many thousands of dollars, discourages some borrowers from enrolling in IDR – including struggling borrowers who may be at risk of delinquency or default. Regardless of the reason, discharged or forgiven student loan debt should never be treated as taxable income. This change would remove a barrier to enrollment in IDR as well as correct the inequity of exempting from taxation the debt forgiven due to school closures or for pursuing public service careers, while taxing loan forgiveness for totally and permanently disabled borrowers and for those who have made 20 or 25 years of income-driven payments.

²⁶ Consumer Financial Protection Bureau. 2013. *Student Loan Affordability: Analysis of Public Input on Impact and Solutions*. <http://bit.ly/1jLlibV>. Federal Reserve Bank of New York. 2013. "Young Student Loan Borrowers Retreat from Housing and Auto Markets." <http://bit.ly/1izd1Jw>. Kim, Dongbin and Therese S. Eyermann. 2006. "Undergraduate Borrowing and Its Effects on Plans to Attend Graduate School Prior to and After the 1992 Higher Education Act Amendments," *Journal of Student Financial Aid* 36(2): Article 1. <http://publications.nasfaa.org/isfa/vol36/iss2/1>.

²⁷ Raskin, Sarah Bloom. Former Deputy Secretary of the U.S. Treasury. September 29, 2014. Remarks at the Annual Meeting of the National Association of Business Economics (NABE). <http://bit.ly/2paxVub>. Lee, Donghoon. Federal Reserve Bank of New York. 2013. Presentation for Press Briefing. "Household Debt and Credit: Student Debt." <http://nyfed.org/2pb3y1r>. National Association of Realtors. June 18, 2012. Blog post. "Impact of Student Debt on Future Housing Demand." <http://bit.ly/1uGUD4S>. Young Invincibles. 2012. *Denied? The Impact of Student Debt on the Ability to Buy a House*. <http://bit.ly/KhNura>.

²⁸ Consumer Financial Protection Bureau. 2017. *Snapshot of Older Consumers and Student Loan Debt*. <http://bit.ly/2ips667>. U.S. Government Accountability Office. 2014. *Older Americans: Inability to Repay Student Loans May Affect Financial Security for a Small Percentage of Retirees*. <http://www.gao.gov/assets/670/665709.pdf>.

Debt forgiven under IDR is not a windfall of income, and borrowers should not be hit with a large tax bill after making payments for 20 or 25 years.

Consider a small business owner who is repaying \$50,000 in federal loans in 2014 IBR.²⁹ He has no income for the first three years, while building his business, and then starts earning \$45,000. He gets married in year 7 and his spouse earns \$30,000 a year. They have a child in year 9 and his spouse starts working part-time, earning \$20,000 a year. They have another child in year 11. After 20 years of responsible payments, he has paid back his original \$50,000 debt plus \$21,650 in interest, and the remaining balance of \$46,150 (current dollars) is forgiven. His family's federal tax liability on that forgiven debt would be an estimated \$13,050, *more than doubling their overall tax bill*. If they are unable to pay the full tax liability in one year, they may face additional costs due to IRS penalties and interest on the unpaid amount.

Debt forgiven under IDR is not a windfall of income, and borrowers should not be hit with a large tax bill after making responsible payments for 20 years (or in some existing IDR plans, 25 years), particularly since the borrowers who end up receiving student loan forgiveness will be those with low incomes relative to their debt for a long time. Bipartisan legislation to eliminate the taxation of debt forgiven under IDR was introduced in the past and supported by a broad constituency of colleges, student loan lenders, financial aid officers, and student advocates.³⁰ The benefit of loan forgiveness for borrowers is severely undermined if forgiven loan balances are treated as taxable income, immediately replacing one unaffordable debt with another.

INCOME-DRIVEN REPAYMENT VS. PUBLIC SERVICE LOAN FORGIVENESS

It is not uncommon to hear that income-driven repayment (IDR) plans forgive borrowers' remaining debt after 10 or 20 years, depending on whether the borrower is employed in the public or nonprofit sector rather than the private sector. In fact, the potential forgiveness of remaining debt after 10 years is through a separate program, called Public Service Loan Forgiveness (PSLF). Congress established PSLF in 2007 to encourage students to enter public service professions, particularly those that require extensive education and training. The program forgives any remaining debt for borrowers who have made 10 years of qualifying student loan payments while working full-time in a public service job. While borrowers seeking forgiveness under PSLF must be enrolled in IDR at some point to have any debt left to forgive,³¹ PSLF is not a repayment plan. Any concerns related to PSLF program design or outcomes should be addressed directly, rather than indirectly through attempted changes to IDR that would have implications for all borrowers and not just those pursuing PSLF.

²⁹ For more detail about this borrower example, see Appendix.

³⁰ TICAS. "Real Loan Forgiveness." <http://ticas.org/initiative/real-loan-forgiveness>.

³¹ One of the requirements for PSLF is that borrowers make payments under qualifying repayment plans, which include the 10-year standard repayment plan and all IDR plans. However, if borrowers only repay under the 10-year standard plan, there will be no remaining balance left to forgive after making 120 qualifying monthly PSLF payments. Therefore, borrowers must be enrolled in IDR at some point in order to receive PSLF. For more information about PSLF, see the Department of Education's website, StudentAid.gov/publicservice.

AUTOMATED ANNUAL INCOME RECERTIFICATION

Data from the Department of Education show that more than half of borrowers (57%) enrolled in IDR plans missed their annual deadline to recertify their income.³² Failure to recertify on time can lead to unaffordable spikes in monthly payment amounts that increase the risk of delinquency and default, as well as interest capitalization that can add substantial costs. For example, a single borrower with \$30,000 in debt and an income of \$35,000 would owe \$141 a month under 2014 IBR, but would owe \$345 a month – more than twice as much – if he or she missed the income recertification deadline.

Bipartisan groups of lawmakers in both the House and the Senate, advocates for students and consumers, higher education leaders, financial aid administrators, and loan servicers have all called for automating the annual IDR recertification process.³³ Allowing borrowers to give advance permission for the Department of Education to automatically access their required tax information (sometimes called “multi-year consent”) will make it significantly easier for borrowers to continue making payments based on income and stay on top of their payments. Borrowers used to be able to do this, and they should be able to again.³⁴ Borrowers would be able to revoke their permission to access their tax data at any time. This change will also reduce the paperwork burden on student loan servicers. The U.S. Departments of Treasury and Education recently announced an agreement to automate this process but have not announced a specific plan or timeline for implementation.³⁵ Meanwhile, a bipartisan bill introduced in Congress would require that the annual IDR recertification process be automated.³⁶

BETTER TARGET BENEFITS TO BORROWERS WHO NEED THEM THE MOST

Design features in some of the existing IDR plans allow some high-debt, high-income borrowers to pay a smaller share of their income than other borrowers and receive substantial loan forgiveness when they could have afforded to pay more. They also allow certain married borrowers to pay less based on their tax filing status. There is broad bipartisan support for better targeting the benefits of IDR, but differing approaches for how to do it. To better target the benefits of IDR to borrowers who need them most, we propose the following three changes.

³² U.S. Department of Education. “Sample Data on IDR Recertification Rates for ED-Held Loans.” Shared on April 1, 2015 at the second negotiated rulemaking session. <http://bit.ly/2pTKFDI>.

³³ TICAS. February 14, 2017. Blog Post. “Progress and Bipartisan Agreement on Helping Keep Student Loan Payments Affordable.” <http://bit.ly/2pTQalj>.

³⁴ U.S. Department of Education. “William D. Ford Federal Direct Loan Program, Income Contingent Repayment Plan & Income-Based Repayment Plan Consent to Disclosure of Tax Information.” OMB No. 1845-0017. <http://bit.ly/2p54zgw>. Borrowers used this form to authorize the IRS to provide their income information for five years (2008-2012). It expired on June 30, 2012.

³⁵ U.S. Department of Education. January 17, 2017. Press Release. “Treasury and Education Announce Progress Toward Multi-Year Income Certification System for Student Loan Borrowers in Income-Driven Repayment Plans.” <http://bit.ly/2jULJDN>.

³⁶ SIMPLE Act (H.R. 5962), introduced September 8, 2016. <http://bit.ly/2cM6S1r>.

Ensure borrowers in IDR are always making payments based on income

The way monthly payments are capped in some existing IDR plans (PAYE and IBR) results in some high-income borrowers paying a smaller share of their income than lower income borrowers. In these plans, monthly payments are capped at the “permanent standard” amount – the monthly amount the borrower would have had to repay had she entered a fixed 10-year repayment plan with what she owed when she entered IDR. Borrowers whose incomes rise above the point where they must start paying the permanent standard amount are, by definition, paying a smaller share of their discretionary income than borrowers making income-driven payments.

For example, a borrower with \$30,000 debt would pay 10% of her discretionary income in 2014 IBR if she earned \$35,000 a year, but only 5% of her discretionary income if she earned \$100,000 a year.³⁷ This is because the standard payment cap holds her payment at \$345 per month. If set at 10% of her discretionary income, her monthly payment would be \$683 per month, based on an income of \$100,000.

House and Senate bipartisan legislative proposals as well as the newest IDR plan, REPAYE, eliminate this “standard payment cap” so that borrowers are always making payments based on their income.³⁸ Removing the standard payment cap increases program fairness and targeting by requiring higher income borrowers to pay the same share of their income as lower income borrowers, and by preventing high-debt, high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.

Note that removing the standard payment cap necessitates additional changes to the required payment amount for borrowers who do not submit their annual income documentation on time. If automated annual income recertification is available (see page 14), this will be less of an issue for borrowers. To avoid rewarding borrowers who fail to submit updated income documentation after their incomes rise, such borrowers should be required to pay the greater of the “permanent standard” amount or their previous income-driven payment amount (based on the last income information they provided). Additionally, borrowers who do not update their income information should not have their monthly payments count toward forgiveness until they provide the required documentation and resume making income-driven payments.

Gradually phase out the income exclusion for borrowers with high incomes

To further target the benefits of IDR to the borrowers who need them most, we also propose gradually phasing out the income exclusion for borrowers with adjusted gross incomes (AGIs) over \$100,000. Borrowers with incomes above this level can afford to spend a larger share of their total income on loan payments and still have sufficient funds to cover basic necessities, such as food and housing. By phasing the exclusion

³⁷ For more detail about this borrower example, see Appendix.

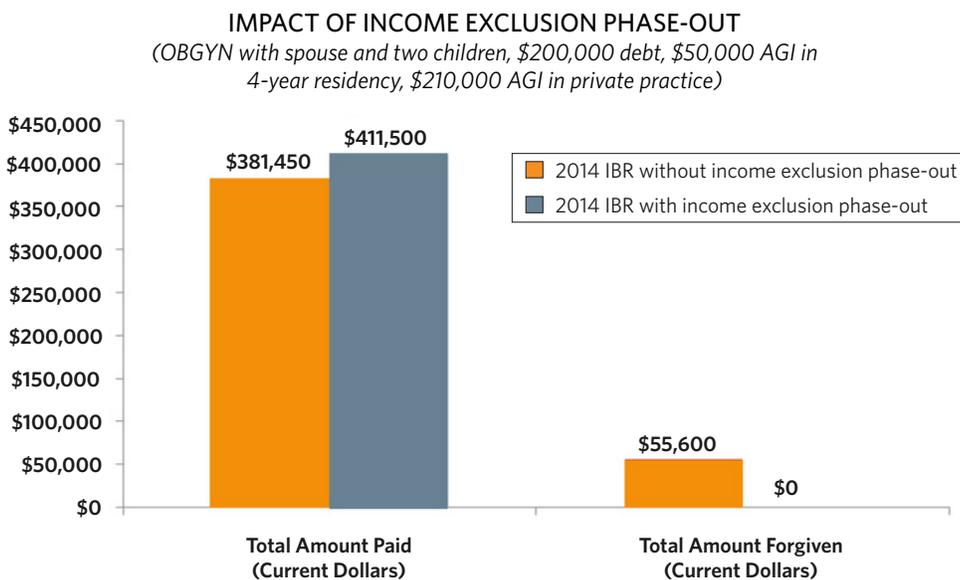
³⁸ Dynamic Repayment Act of 2017 (S. 799), introduced March 31, 2017, <http://bit.ly/2pL9Urx>; ExCEL Act of 2015 (H.R. 3752), introduced October 9, 2015, <http://bit.ly/1hD1hcM>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://bit.ly/2otSpli>. For more information about REPAYE and the other existing IDR plans, see the Department of Education’s website, StudentAid.gov/IDR.

out gradually, our proposal avoids creating a cliff where \$1 more in income would result in a sudden large change in monthly payment amounts. The AGI level at which the income exclusion phase-out begins would be indexed to inflation, so it does not decline in real value over time.

The income exclusion would remain 150% of the poverty level (based on the borrower’s household size and state of residence) up to an AGI of \$100,000 and then phased out, reducing by one percentage point for each \$1,000 of AGI above \$100,000, until completely phased out at \$251,000. For example, at an AGI of \$101,000, the income exclusion would be 149% of poverty; at an AGI of \$102,000, the income exclusion would be 148% of poverty; and so forth until it reaches 0% at an AGI of \$251,000. Alternatively, the rate could be adjusted to make the income exclusion phase out more quickly and within a smaller income range (e.g., two percentage points per \$1,000 above \$100,000 AGI, zeroing out at \$176,000 AGI).

For example, consider an OBGYN who is married with two children.³⁹ She has \$200,000 in debt and earns \$50,000 a year for a 4-year residency, then \$210,000 in private practice, increasing 4% a year. As shown in Figure 7 below, she would pay about \$30,000 less and receive almost \$56,000 more in loan forgiveness in 2014 IBR than if the income exclusion were phased out.

Figure 7: High-income borrower pays more in total and gets less forgiveness in IDR with an income exclusion phase-out



³⁹ Her household size decreases in years 10 and 15 as her children leave home. For more detail about this borrower example, see Appendix.

Treat married borrowers consistently, regardless of how they file income taxes

In some existing IDR plans, married borrowers can get lower monthly payments if they file their taxes separately than if they file jointly. Married borrowers in IDR who file their federal taxes jointly have their eligibility and payment amounts based on their combined income and combined federal debt. However, in some IDR plans, those who file separately can exclude their spouse's income from payment calculations, but still include their spouse in their family size (for the calculation of the income exclusion). A married borrower who earns a low income and files taxes separately could have very low or even \$0 monthly payments, even if his spouse is a high earner, with the payment lowered even further by being able to count the spouse in his family size.

In the most recent IDR plan (REPAYE) and in bipartisan legislation introduced in the Senate,⁴⁰ the monthly payment for married borrowers is calculated based on the couple's combined income regardless of how they file federal taxes. Importantly, there is an exception for borrowers who are separated from their spouse or cannot reasonably access their spouse's income information (e.g., in cases of domestic violence). REPAYE also adjusts the definition of "family size" to exclude the borrower's spouse if the spouse's income is not included in the payment calculation. It does not make sense to allow borrowers to exclude their spouse's income from the monthly payment calculation but still include them in their family size. IDR plans should count household incomes and family sizes consistently in order to increase equity and better target IDR benefits.

RESTRAIN GROWTH OF ACCUMULATED INTEREST

Ballooning loan balances can be distressing, add costs, and dissuade borrowers from enrolling in IDR.

One important benefit of IDR is that it helps borrowers remain current on their student loans by calculating monthly payments as a percentage of their income. Those with incomes below 150% of the poverty line are not expected to make monthly payments until their incomes increase. For borrowers who experience periods of low or no income, however, this can lead to payments that do not cover the accumulating interest on their loans (called "negative amortization"), causing balances to grow even as borrowers continue to make payments in IDR. These ballooning loan balances can be distressing, can add costs for borrowers, and can dissuade borrowers from enrolling in IDR even if they would benefit from doing so. For example, focus groups conducted for New America found that borrowers in IDR generally like it and think the benefits outweigh the costs, but that student loan borrowers in general felt discouraged, even hopeless, when their loan balances grew despite making monthly payments.⁴¹ To address these concerns, we recommend both of the changes detailed below.

Restrain growth of unpaid interest for borrowers with low incomes relative to their debt

Capping the accrual of unpaid interest for borrowers with negatively amortizing loans is a targeted benefit that helps minimize the growth of loan balances for borrowers with low incomes relative to their debt. We recommend the interest accrual provisions

⁴⁰ Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://1.usa.gov/1AU7U2t>. For more information about REPAYE and the other existing IDR plans, see the Department of Education's website, StudentAid.gov/IDR.

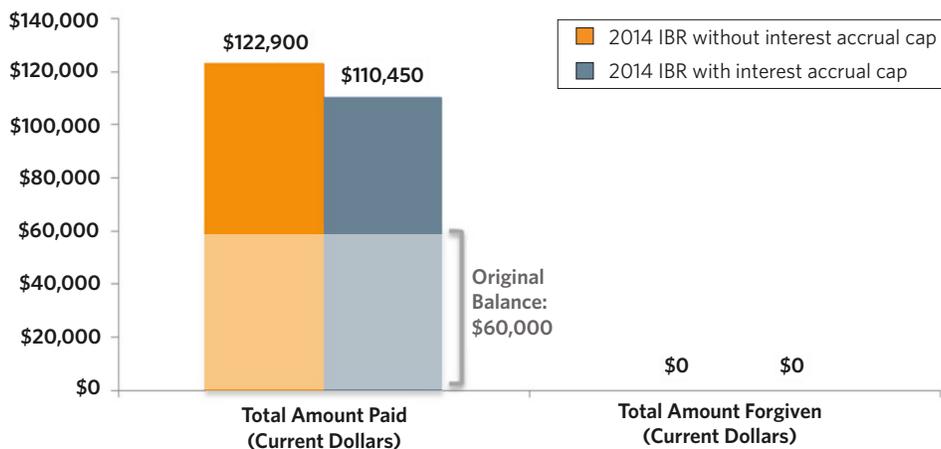
⁴¹ FDR Group. 2015. *Taking Out and Repaying Student Loans: A Report on Focus Groups with Struggling Student Loan Borrowers*. <http://bit.ly/2ptnTVR>.

that are already incorporated into the newest IDR plan (REPAYE), a form of which is also included in bipartisan legislation introduced in the Senate.⁴² These provisions specify that when borrowers' monthly payments are too low to cover interest charges, no unpaid interest will accrue on their subsidized loans during their first three years in IDR.⁴³ After the first three years, only 50% of any unpaid interest should ever accrue on subsidized loans, and only 50% of any unpaid interest should accrue on unsubsidized loans any time borrowers are in negative amortization. This will reduce the amount of unpaid interest for negatively amortizing borrowers, helping them potentially pay off their loans more quickly, pay less in total, or reduce the amount they need to have forgiven.⁴⁴

Consider a married couple with a child and \$60,000 in combined student debt.⁴⁵ The family relies on a single income of \$40,000 while one parent stays at home with the child. That parent goes back to work in year 5 and their combined income is \$90,000. By limiting the growth of unpaid interest, this interest accrual cap reduces the total amount they have to pay. As shown in Figure 8, the family ends up paying \$12,450 less in total with the interest accrual cap (\$110,450 vs. \$122,900) but still repay their loans in full, so they do not receive any forgiveness.

Figure 8: Couple pays less in total in IDR with interest accrual cap

INTEREST ACCRUAL CAP REDUCES TOTAL AMOUNT PAID
(Married couple with child, \$60,000 debt, \$40,000 AGI in first year, \$90,000 in year 5)



⁴² Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://1.usa.gov/1AU7U2t>.

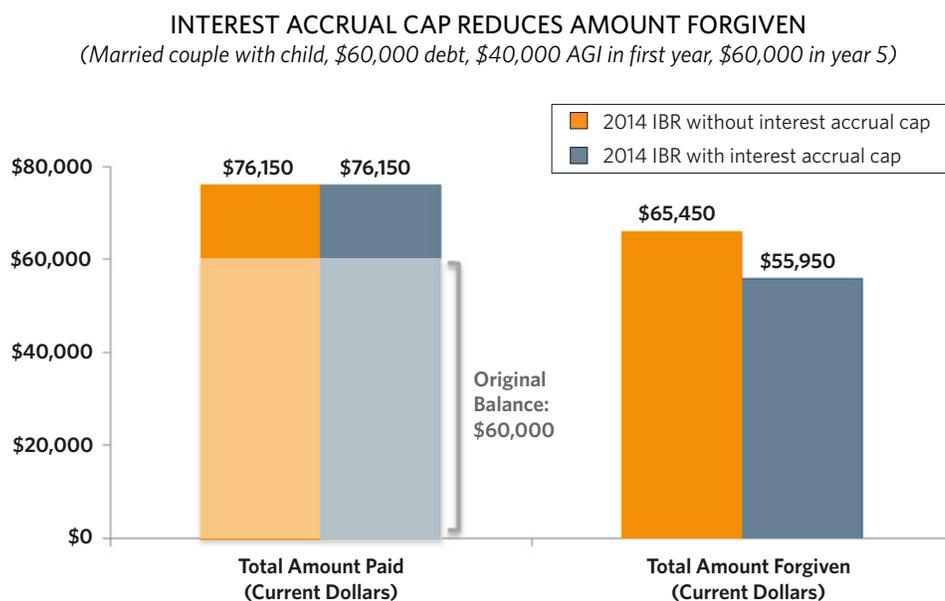
⁴³ Subsidized loans are only available to undergraduate students with financial need, meaning that their cost of attendance is higher than the amount their family is expected to cover (expected family contribution). For more information, see the Department of Education's website, <https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized>.

⁴⁴ Others have suggested setting a specific limit on how high loan balances can grow (e.g., capping total accrued interest at 50% of the original loan amount), but those proposals will not help borrowers until they hit that high cap, and borrowers who do hit the interest accrual cap would likely see a reduction only in the amount they have forgiven, not the total amount they end up paying. This is because borrowers who accrue enough interest to hit such a high cap are unlikely to earn enough to fully repay their loans within 20 years.

⁴⁵ Their household size decreases in year 15 when their child leaves home. For more detail about this borrower example, see Appendix.

If the second parent goes back to work only part time in year 5, so that their combined income is \$60,000, the interest accrual cap will hold down the growth of their loan balances so that they have less forgiven after 20 years of payments. As shown in Figure 9, the parents will have almost \$10,000 less forgiven after 20 years of payments (\$55,950 vs. \$65,450). The interest accrual cap will *not* affect the total amount they pay.

Figure 9: Couple receives less forgiveness in IDR with interest accrual cap



Eliminate the capitalization of unpaid interest in IDR plans

Eliminating the capitalization of unpaid interest also helps limit the growth of loan balances for borrowers whose incomes are low for extended periods of time, as well as for borrowers who need to take a deferment or forbearance while in IDR due to unexpected life events or expenses. It also greatly simplifies IDR implementation and communications.

When capitalization occurs, all of a borrower’s unpaid accrued interest is added to her outstanding principal balance, meaning that new interest begins accruing on a higher loan balance and her total amount owed will grow faster than it would have without the capitalization. As a result, borrowers may end up paying much more in total, over a longer period of time, or have larger amounts forgiven. The effect of interest capitalization is most pronounced for borrowers with low incomes relative to their debt for many years, during which time their IDR payments are lower than accruing interest.

Currently, in the existing IDR plans, interest capitalization is triggered by different events depending on the plan. In one plan (ICR), unpaid interest capitalizes annually. In other plans (PAYE and IBR), interest capitalizes when income increases or family size changes enough to eliminate a borrower’s “partial financial hardship” (PFH)⁴⁶ and

⁴⁶ As discussed on page 6, we propose removing the PFH enrollment requirement, so it will no longer be necessary to track PFH and capitalize interest when borrowers’ debt-to-income ratio changes.

when a borrower misses the annual deadline to update income information. Some plans have a limit on how much interest can capitalize while others have no limit. Removing interest capitalization while borrowers are in an IDR plan would greatly simplify the program for both borrowers and servicers, eliminating the need to explain or track triggering events and limits.

Additionally, in all IDR plans, interest can capitalize after borrowers exit a deferment or forbearance – *all* unpaid interest, not just the interest that accrues during the deferment or forbearance. A recent GAO report found that 18% of borrowers in IBR and 13% of borrowers in PAYE were in deferment or forbearance in September 2014.⁴⁷ Borrowers who experience hardship while in IDR and need to take a deferment or forbearance should not be penalized with interest capitalization, especially if they have accrued a large amount of unpaid interest due to many years of low earnings.

COUNT ALL QUALIFYING PAYMENTS – MADE BEFORE OR AFTER CONSOLIDATION – TOWARD LOAN FORGIVENESS

Currently, if a borrower makes IDR payments on a loan and then consolidates it with other loans, those qualifying payments do not count toward forgiveness in IDR – the clock starts over. Borrowers who consolidate their loans should get the appropriate credit for what may be years of qualifying payments. For example, consider a student with undergraduate Stafford loans who makes 10 years' worth of payments under 2014 IBR. She decides to go back to school for a master's degree to expand her job opportunities and takes out graduate Stafford loans. After completing her master's degree, she consolidates her graduate loans with her undergraduate loans. Under current rules, she would have to make an additional 20 years of payments on her undergraduate loans before being eligible for forgiveness of any remaining debt on those loans (if she has not already paid them off), even though she has already made 10 years of payments on those loans – turning what should be a 20-year repayment period into 30 years. To avoid this, loans that borrowers were repaying before consolidation should be tracked separately, so that borrowers do not lose credit for payments they have already made.

There are multiple precedents for tracking payments made on loans before consolidation. For example, servicers already track pre-consolidation payments on subsidized loans in order to provide a three-year period of interest subsidy on negatively amortized subsidized loans in certain IDR plans.⁴⁸ Additionally, for discharges of consolidation loans due to a closed school, false certification, or unpaid refunds, only the amount of the underlying loans that were used to pay for the affected program of study are considered for discharge.⁴⁹

⁴⁷ U.S. Government Accountability Office. 2015. *Federal Student Loans: Education Could Do More to Help Ensure Borrowers are Aware of Repayment and Forgiveness Options*. <http://www.gao.gov/assets/680/672136.pdf>.

⁴⁸ 682.215(b)(4), 685.209(a)(2)(iii), 685.209(c)(2)(iii), and 685.221(b)(3).

⁴⁹ U.S. Department of Education. *Loan Discharge Application: School Closure*. Expiration date 08/31/2017. <http://1.usa.gov/Zuy9vN>. U.S. Department of Education. *Loan Discharge Application: False Certification (Ability to Benefit)*. Expiration date 08/31/2017. <http://1.usa.gov/1tHDmlj>. U.S. Department of Education. *Loan Discharge Application: Unpaid Refund*. Expiration date 08/31/2017. <http://1.usa.gov/Zuyaj6>.

AUTOMATICALLY ENROLL DISTRESSED BORROWERS IN IDR

Generally, borrowers should be able to choose between a fixed repayment plan and a single improved IDR plan because IDR is not the best option for all borrowers (see page 7). However, borrowers who are severely delinquent on their loans should be automatically enrolled in IDR to help them avoid the severe consequences of defaulting on their loans.⁵⁰ IDR is always preferable to default, and IDR payments can be as little as \$0 for borrowers with very low incomes.

It takes at least nine months of nonpayment (delinquency) to default on a federal student loan. After a borrower has been delinquent for two months, she should receive information from her loan servicer about IDR, including a monthly payment amount calculated using the borrower's income information from the IRS. The servicer's notification should inform the borrower that if she remains delinquent for two more months (four months total) without changing repayment plans, she will be automatically enrolled in the single improved IDR plan if her monthly payments in IDR would be lower than her current payment. Borrowers should always have the option to opt out from this process. A bipartisan bill in Congress would significantly reduce student loan defaults by implementing procedures similar to those described above to automatically enroll severely delinquent borrowers into an IDR plan.⁵¹ While IDR is not the right repayment plan for everyone, with a record 8.4 million federal student loan borrowers in default,⁵² and about one in four borrowers either delinquent or in default,⁵³ this targeted, common-sense measure is urgently needed.

⁵⁰ TICAS. 2013. *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*. http://www.ticas.org/pub_view.php?idx=873.

⁵¹ SIMPLE Act (H.R. 5962), introduced September 8, 2016. <http://bit.ly/2cM6S1r>.

⁵² Calculations by TICAS using data from the U.S. Department of Education, Federal Student Aid Data Center, "Portfolio by Loan Status (DL, FFEL, ED-Held FFEL, ED-Owned)," <http://bit.ly/1O6zgrW>. Accessed March 9, 2017. Figures represent Direct Loan and FFEL borrowers whose loans are more than 360 days delinquent, and borrowers who defaulted on both a Direct and FFEL Loan are counted more than once.

⁵³ Calculations by TICAS using data from the U.S. Department of Education, Federal Student Aid Data Center, "Federal Student Aid Portfolio Summary," "Direct Loan Portfolio by Loan Status," and "Direct Loan Portfolio by Delinquency Status." <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>. Accessed April 21, 2017. Figures represent Direct Loan borrowers whose loans are more than 30 days delinquent, and borrowers who have Direct Loans in different stages of delinquency or default are counted more than once.

CONCLUSION

All federal student loan borrowers should be able to make a simple and clear choice between one fixed payment plan and one income-driven repayment (IDR) plan. To create this simplified repayment system for borrowers, we have proposed streamlining today's five IDR plans into one improved income-driven plan that caps monthly payments at 10% of income, provides tax-free loan forgiveness after 20 years of payments, and targets benefits to borrowers who need help the most. Additionally, we have proposed replacing the myriad other federal loan repayment plans with a single, easy-to-understand fixed payment plan. To maximize the impact of these changes for borrowers, it is also essential to improve loan counseling and servicing, and make more data available for transparency and accountability.

Improve the timing, content, and effectiveness of student loan counseling. There is bipartisan support for improving required federal loan counseling to help students borrow wisely and pick the repayment plan that works best for them.⁵⁴ The Department of Education's online counseling tools should be rigorously consumer-tested and evaluated to ensure that their content is accessible, meaningful, and relevant to the borrowing decisions students make at different stages of enrollment.⁵⁵ This includes determining the appropriate level of personalization that enhances user experience and decision-making. While entrance counseling can help students make initial borrowing decisions that are right for them, allowing schools to require *annual* loan counseling could help ensure that students continue to have access to the critical information they need to make sound borrowing decisions throughout their enrollment. Exit counseling can also play a critical role in helping students decide the best way to repay their loans, and must be improved to clearly communicate the trade-offs of different repayment options. The Department's exit counseling tool should guide borrowers to consider a shorter term repayment plan if they want to reduce their debt's overall cost and can afford to pay it down faster, and it should guide borrowers who want assurance that their monthly payments will remain affordable to the new and improved IDR plan.

Improve student loan servicing quality, consistency, and accountability. In August 2016, House Education and the Workforce Committee Chairman John Kline and Higher Education and Workforce Training Subcommittee Chairwoman Virginia Foxx sent a letter to the Secretary of Education documenting the need for improvements to student loan servicing, citing issues including inadequate oversight of contractors, a lack of minimum standards, and inconsistent and inefficient services to borrowers.⁵⁶ We share many of the concerns cited in this letter. Among other changes, the Department of Education should redesign its contracts with servicers to better align financial incentives with the provision of high-quality student loan servicing and enforce those contracts when servicers underperform, so that borrowers receive clear, consistent, and timely services. Contracts and federal policies should ensure appropriate levels of servicer accountability so that loans are serviced in both a high-quality and cost-effective manner.

⁵⁴ U.S. House of Representatives Committee on Education and the Workforce. 2016. "Bill Summary: The Empowering Students Through Enhanced Financial Counseling Act." <http://bit.ly/2hxHm3Y>.

⁵⁵ For our detailed recommendations for improving federal student loan counseling, see TICAS. 2016. *Recommendations for Improving Federal Online Student Loan Counseling*. <http://bit.ly/2q4v3Mv>.

⁵⁶ U.S. House of Representatives Committee on Education and the Workforce. August 8, 2016. Press Release. "Committee Raises Concerns with FSA Management, Single Servicer Proposal." <http://bit.ly/2pqJNjn>.

A simplified and improved repayment system will help more students successfully repay their loans and avoid default, strengthening the broader economy.

Improve data transparency to better inform policy and accountability. The Department of Education currently publishes broad summary data on federal student loans on a quarterly basis via the Federal Student Aid Data Center.⁵⁷ However, more detailed, comprehensive, and servicer-level data are necessary to improve servicing and counseling, as well as to inform policies on loans and repayment. For example, borrowers have reported issues with payment processing, getting information about repayment options, enrolling in IDR, and continuing to make payments in IDR based on income.⁵⁸ Collecting and publishing servicer-level data on loan defaults and IDR applications and recertifications – including processing times for IDR applications and how many borrowers missed the deadline to update their income – would help establish how widespread or concentrated such problems are among servicers. The Consumer Financial Protection Bureau (CFPB) has proposed collecting new information from student loan servicers, including those servicing commercial FFEL and private loans as well as Direct Loans.⁵⁹ This will provide much-needed information on the larger student loan market, though specific servicers will not be identified.

A simplified and improved federal student loan repayment system like the one we have proposed, combined with more effective student loan counseling, improved student loan servicing, and increased transparency, will help more students successfully repay their loans and avoid default, ultimately strengthening the broader economy.

However, even the most optimally designed loan repayment system will not directly address the underlying problems of rising college costs and debt. Loan repayment is just one aspect of our federal loan program, which also includes interest rates, loan limits, and other factors that can affect the cost and amount of student debt – elements that are also in need of improvement.⁶⁰ To fully support and increase college access and success for all students, changes to student loans and loan repayment will need to be paired with other federal reforms, including increased need-based grant aid, more accessible and comparable consumer information by college and program, and increased college accountability.⁶¹ New federal funding contingent on states maintaining and increasing support for public colleges and need-based grant aid would also provide a vital incentive that would help reverse state disinvestment in public higher education.

This report provides practical recommendations for improving federal loan repayment so that borrowers can make a simple choice between two well-designed options. As long as our higher education system includes student loans, and loans remain necessary for most students to get through college, borrowers and the American economy will benefit from a better loan repayment system.

⁵⁷ U.S. Department of Education. Federal Student Aid Data Center. "Federal Loan Portfolio." <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.

⁵⁸ Consumer Financial Protection Bureau. 2016. *Midyear update on student loan complaints: Income-driven repayment plan application issues*. <http://bit.ly/2czyiHT>. Consumer Financial Protection Bureau. 2017. *Consumer Response Annual Report*. <http://bit.ly/2nlh7WZ>.

⁵⁹ Consumer Financial Protection Bureau. February 16, 2017. Blog Post. "Increasing transparency in the student loan servicing market." <http://bit.ly/2lOeFRI>.

⁶⁰ TICAS. 2013. *Improving Federal Student Loans for Undergraduates*. <http://bit.ly/2hxd3u0>.

⁶¹ TICAS. 2016. "National Policy Agenda to Reduce the Burden of Student Debt." <http://ticas.org/initiative/student-debt-policy-agenda>.

APPENDIX: METHODOLOGY FOR BORROWER EXAMPLES

In general, this paper uses the most recent plan passed by Congress, the Income-Based Repayment plan for “new borrowers” (2014 IBR), as the baseline for illustrating the impact of specific proposals. 2014 IBR is available to borrowers who took out their first federal student loan on or after July 1, 2014 and have a “partial financial hardship”, meaning that their calculated payment based on income and family size is less than what they would pay under the fixed 10-year repayment plan. Monthly payments are calculated as 10% of discretionary income, up to the fixed 10-year payment amount. Discretionary income is defined as the amount of adjusted gross income (AGI) above 150% of the poverty level for the borrower’s household size and state. Any remaining debt is forgiven after 20 years of qualifying payments. More information about this and other existing IDR plans can be found in Figure 1 and at the Department of Education’s website, StudentAid.gov/IDR.

Unless otherwise noted, the calculations for the example borrowers in this paper are based on the following assumptions:

- The borrower is single, does not have anyone else in the household, and lives in one of the 48 contiguous states.
- The borrower’s adjusted gross income (AGI) increases 4% a year.
- The average interest rate on his or her loans is 6.80%, and the loans are unsubsidized.
- The income exclusion is 150% of the poverty level for the borrower’s household size, as under most of the existing IDR plans (Original IBR, 2014 IBR, PAYE, and REPAYE).
- Calculations are based on 2017 poverty levels and assume that the poverty level increases annually at the rate of inflation.

Additionally:

- All incomes referenced in this paper are AGIs.
- Debt amounts in this paper refer to the borrower’s federal loan balance when entering the IDR plan.
- Unless otherwise noted, total amounts paid and forgiven are provided in current dollars. Where total payments are adjusted for inflation, they are discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years.
- Monthly payments are rounded to the nearest \$1, while total payments and forgiven amounts are rounded to the nearest \$50.

Note that monthly payments, total costs, and forgiven amounts are affected by a multitude of factors specific to the borrower, including his or her debt amount, household size, and income trajectory over the repayment period.

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