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# An Updated Look at Student Loan Debt Repayment and Default

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# An Updated Look at Student Loan Debt Repayment and Default

## Summary

Over 41 million Americans now owe more than \$1.2 trillion in outstanding federal student loan debt. Policymakers are considering a number of amendments related to federal student aid programs in the context of the Higher Education Act reauthorization. In addition to providing a snapshot of key data related to student loan debt that all policymakers should consider, this brief discusses recommendations for facilitating repayment and curbing defaults on student loans, including: protecting students from low-performing institutions; encouraging use of forbearance and deferment mechanisms; and strengthening income-driven repayment options.

## Disciplines

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# An Updated Look at Student Loan Debt Repayment and Default

Laura W. Perna, PhD; James Kvaal, JD; and Roman Ruiz, MEd

ISSUE BRIEF

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This year, the Senate Committee on Health, Education, Labor and Pensions and the House Committee on Education and the Workforce are once again preparing for the reauthorization of the Higher Education Act (HEA): the law that governs the administration of federal student aid programs.<sup>1</sup>

Since President Lyndon Johnson signed the HEA into law in 1965, Congress has renewed it eight times, most recently in 2008. It was scheduled again for review in 2013. For the next iteration, lawmakers are considering a host of amendments, addressing issues including regulatory burden, FAFSA simplification, and the need for more complete consumer information about student loan programs.

The priorities of the new Administration are also coming into focus. The President's budget proposal would simplify the income-driven student loan repayment plans, making the terms slightly more generous for some undergraduates while eliminating public service loan forgiveness and extending the repayment period for graduate students to 30 years. It would also eliminate the interest-free deferment that low-income students receive while they are enrolled in school. Together, these changes would reduce government costs by approximately \$150 billion over the next 10 years.<sup>2</sup>

Meanwhile, the U.S. Department of Education (ED) is reconsidering previous efforts to protect students against student loan debt. The gainful employ-

## SUMMARY

- Lawmakers are currently considering new amendments to the Higher Education Act that will impact the administration of federal student aid programs. To aid those discussions, this Issue Brief highlights the current state of loan repayment, reviews key considerations for federal student loan policy, and offers recommendations for facilitating repayment and curbing defaults.
- More than a million students defaulted on their Federal Direct Loans in 2015, often with serious consequences. Default rates are considerably higher for borrowers who drop out than for borrowers who complete their programs. Loan repayment also is more problematic for students that attend for-profit institutions.
- Federal policymakers may reduce the risk of non-repayment in a few key ways: by protecting students from low-performing educational institutions, encouraging use of loan forbearance and deferment mechanisms, and strengthening income-driven repayment options.
- Income-driven repayment and loan forgiveness programs can help borrowers repay their obligations, but they must be accompanied by protections against low-quality colleges to avoid imposing costs on taxpayers.



ment and borrower defense regulations, which protect students against high debt burdens and fraudulent claims, are likely to be substantially revised. ED has withdrawn its strategy to overhaul student loan collection contracts, and the career official responsible for managing the student aid programs has resigned.<sup>3</sup>

These shifts are occurring amid a landscape of student debt – borrowers, debt amounts, repayments, and defaults – that has changed markedly since 2008. Over 41 million Americans now owe more than \$1.2 trillion in outstanding federal loan debt, and the debt load carried by students and their families has tripled over the past decade.<sup>4</sup> Policymakers must pay attention to the new realities of a rapidly expanding population of current and future borrowers. As an aid to policymakers, this Issue Brief highlights the current state of loan repayment, addresses the implications of this new landscape for federal student loan policy, and offers recommendations for facilitating repayment and curbing defaults.

## A SNAPSHOT OF DEBT AND THE INDICATORS OF DEFAULT

For more than a half-century, the U.S.

federal government has made loans available to college students to serve national interests, including national security, economic development, and educational equity. This practice has benefited students enormously. Even students with other sources of credit, including private student loans and credit cards, are better served by federal loans, as federal loans have lower interest rates, provisions for deferment and forbearance, variable repayment terms, and debt forgiveness programs.<sup>5</sup>

The federal loan system in the U.S. includes multiple types of loans, each with unique eligibility requirements and borrowing limits.<sup>6</sup> Six percent of undergraduates had private loans in 2011-12, down from 14 percent in 2007-08, and 5 percent had Parent PLUS loans, up from 4 percent in 2007-08.<sup>7</sup> Of those undergraduates who borrowed in 2011-12, 85 percent had only federal loans, while 11 percent had both federal and private loans, and 3 percent had only private loans.<sup>8</sup> In 2015-16, 50 percent of the \$119 billion in federal financial aid received by undergraduates – and 33 percent of the \$184 billion in all aid received by undergraduates (including federal education tax credits and deductions and grants from the

federal and state governments, institutions, and other sources) – was in the form of federal loans.<sup>9</sup> As for graduate students, they received about 36 percent of 2015 federal loan disbursements (including Grad PLUS) and, in 2015-16, 63 percent of all aid to graduate students was in the form of federal loans.<sup>10</sup>

Most students borrow little relative to the economic benefits of a college education. A typical college graduate with loans borrows less than \$30,000, and will earn \$500,000 more (on a present value basis) than a typical high school graduate.<sup>11</sup> But policymakers and researchers should not overlook the meaningful number of students who struggle to manage and repay their loans.<sup>12</sup>

**More than a million students defaulted on their Federal Direct Loans in 2015, often with serious consequences.**<sup>13</sup> Our nation's heavy reliance on student loans to pay college costs is most problematic for students who fail to earn a quality degree, students who have difficulty repaying loan debt, and students who borrow too little (and consequently do not enroll, enroll part-time rather than full-time, and/or engage in high levels of paid employment while pursuing their degree).

## NOTES

1 Andrew Ujifusa, "Congress May Turn Focus to Higher Ed. Law's Renewal," *Education Week*, March 1, 2017.  
2 Office of Management and Budget, "Budget of the U.S. Government, Fiscal Year 2018: A New Foundation for American Greatness," 2017.  
3 [https://www.washingtonpost.com/news/grade-point/wp/2017/05/24/federal-student-aid-chief-quits-warning-of-management-issues-under-devos/?utm\\_term=.682afd6d525d](https://www.washingtonpost.com/news/grade-point/wp/2017/05/24/federal-student-aid-chief-quits-warning-of-management-issues-under-devos/?utm_term=.682afd6d525d). Education Secretary Betsy DeVos has appointed financial services executive A. Wayne Johnson to head the Federal Student Aid office.

4 The primary source for this Issue Brief is Nicholas Hillman and Laura Perna (eds.), "Understanding Student Debt: Who Borrows, the Consequences of Borrowing, and the Implications for Federal Policy," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), May 2017.  
5 <https://studentaid.ed.gov/sa/types/loans#why-federal>.

6 College Board, Types of College Loans. Available: <https://bigfuture.collegeboard.org/pay-for-college/loans/types-of-college-loans>.  
7 Jennie H. Woo, Eric D. Velez, and Sean A. Simone, "Use

of Private Loans by Postsecondary Students: Select Years 2003-04 Through 2011-12," National Center for Education Statistics (NCES 2017-420), 2016.

8 Ibid.

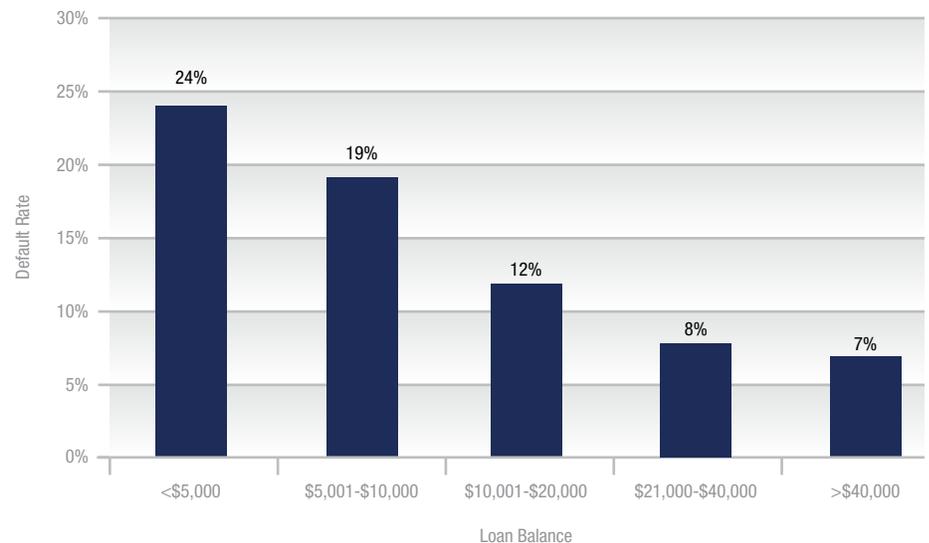
9 College Board, *Trends in Student Aid 2016*. Available: <https://trends.collegeboard.org/student-aid>.

10 Ibid (2016); Nicholas W. Hillman, "Designing and Assessing Risk-Sharing Models for Federal Student Aid," Working paper, Wisconsin Center for Advancement of Postsecondary Education, December 19, 2016. Available: <https://wiscap.wisc.edu/wiscap/publications/working-papers/wp018>.

Default rates are considerably higher for borrowers who drop out than for borrowers who complete their programs.<sup>14</sup> On average, fewer than 6 in 10 students who first enrolled in higher education in the fall of 2009 had completed a degree from any college or university within six years.<sup>15</sup> Among borrowers who entered repayment in 2011-12, the two-year federal student loan default rate was 24 percent for borrowers who did not complete their programs, compared with 9 percent for borrowers who finished.<sup>16</sup>

Partly because of completion problems, default rates are inversely related to the amount borrowed.<sup>17</sup> Figure 1 helps to illustrate this point. Among borrowers who entered repayment in 2011-12, the two-year federal student loan default rate was 24 percent for borrowers with loan balances below \$5,000 and 19 percent for those with loan balances between \$5,001 and \$10,000, but 12 percent for those with loan balances between \$10,001 and \$20,000 and 7 percent for those with loan balances above \$40,000.<sup>18</sup> Students with higher loan debt typically have been enrolled for more semesters (e.g., completed college, pursued graduate or professional studies).<sup>19</sup>

FIGURE 1 BORROWERS ENTERING REPAYMENT: 2011-2012



Source: College Board

Loan repayment may also be difficult for students who complete their degrees but do not go on to earn high incomes.<sup>20</sup> One in 10 college graduates between the ages of 35 and 44 earns less than \$20,000, less than the average income of most high school graduates.<sup>21</sup> While income-driven repayment plans are available, enrolling (and staying enrolled) in these programs is administratively cumbersome and, until recently, awareness of these programs was low.

Loans tend to have more problematic implications for students

who attend for-profit institutions rather than other types of institutions.<sup>22</sup> While there is great variety within each sector, students attending for-profit institutions borrow more, on average, than students attending other institutions largely because the costs of attendance are higher at for-profit institutions.<sup>23</sup> Institutional default rates and non-repayment rates are also higher at for-profit institutions than at institutions in other sectors, even after controlling for other institutional characteristics.<sup>24</sup> Among borrowers who entered repayment in 2008-09,

## NOTES

<sup>11</sup> Council of Economic Advisers, *Investing in Higher Education: Benefits, Challenges, and the State of Student Debt, July 2016* [CEA]. Available: [https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160718\\_cea\\_student\\_debt.pdf](https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160718_cea_student_debt.pdf).

<sup>12</sup> Ibid.

<sup>13</sup> Federal Student Aid, *New Direct Loan Defaults*. Available: <https://studentaid.ed.gov/sa/about/data-center/student/default>. Federal Direct Subsidized and Unsubsidized Loans (formerly known as Stafford Loans) are now available through the William D. Ford Federal Direct Loan Program.

<sup>14</sup> College Board (2016); Lawrence Gladieux and Laura W. Perna, "Borrowers Who Drop Out: A Neglected Aspect of the College on Credit: A Multilevel Analysis of Student Loan Default," National Center for Public Policy and Higher Education, 2005.

<sup>15</sup> Doug Shapiro, Afet Dundar, Phoebe Khasiata Wakhungu, Xin Yuan, Angel Nathan, and Youngsik Hwang, "Completing College: A National View of Student Attainment Rates – Fall 2010 Cohort (Signature Report No. 12)," National Student Clearinghouse Research Center, November 2016.

<sup>16</sup> College Board (2016).

<sup>17</sup> Nicholas W. Hillman, "College on Credit: A Multilevel Analysis of Student Loan Default," *Review of Higher Education* 37 (2014): 169-195.

<sup>18</sup> College Board (2016).

<sup>19</sup> Ibid.; Susan Dynarski, "The Trouble with Student Loans? Low Earnings, Not High Debt," Brookings, January 2016.

<sup>20</sup> Bruce Chapman and Lorraine Dearden, "Conceptual and Empirical Issues for Alternative Student Loan Designs: The Significance of Loan Repayment Burdens for the United States," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), pp. 249 –



five-year federal student loan default rates were considerably higher for borrowers who received their first federal student loan while attending a for-profit (47 percent) institution than for borrowers attending a public two-year (38 percent) institution or a non-selective four-year (27 percent), selective four-year (18 percent), or most selective four-year (10 percent) institution.<sup>25</sup>

### **IMPLICATIONS FOR FEDERAL STUDENT LOAN POLICY**

The goal of federal student loan policy should be to encourage students to enroll and complete a high-quality educational program by enabling students to obtain the financial resources needed to pay college costs, without producing too great a loan repayment burden. The reality is obviously more complex, and student loans are likely to remain a central component of our higher education system for the foreseeable future. Policymakers can ensure that students are well informed about student loans by reducing the complexity of the federal student aid system and simplifying the financial aid application form.<sup>26</sup>

Federal policymakers also must reevaluate several fundamental ques-

tions including: What is a reasonable amount for students to borrow for their education? What is an onerous repayment burden? How should the risk and cost of student loans be shared between students and the government (taxpayers)? Are students making wise decisions about how much to borrow and where to go to college? And for how many years should an individual have to repay a loan in an income-driven repayment plan before the remaining balance is forgiven?

The federal government could further the production of instructive research on these questions by increasing the availability of relevant data (e.g., by collecting data on all enrolled students and not just student aid recipients, more frequently administering the National Postsecondary Student Aid Study and providing public-use files from the National Student Loan Data System), allocating funding to support research on student loans (e.g., through research competitions sponsored by the Institute of Education Sciences), and including evaluation provisions when establishing and refining federal aid programs. As an analysis of the development of Direct Loan policy over three presidential administrations confirmed, there is a relative absence of reliable data and research to

inform policy-related decisions.<sup>27</sup>

With greater access to data, future research could better investigate questions such as: How do federal financial aid policies including loans, grants, and tax credits reinforce, or perhaps undermine, policy objectives? Who is borrowing too much in student loans, and who is borrowing not enough? Does the Public Service Loan Forgiveness program encourage some borrowers to pursue careers in public service? What effects would potential cost-cutting changes have on this program and on borrowers?<sup>28</sup> And what can the federal government learn from the finance policies and practices of state governments or colleges and universities (see Box 1)?

### **POLICY RECOMMENDATIONS FOR FACILITATING REPAYMENT**

Student loans have risks for borrowers, given the low rates of completion at many postsecondary educational institutions, as well as the possibility of short-term and long-term liquidity constraints that prevent loan repayment.<sup>31</sup> Federal policymakers may reduce the risk of non-repayment by protecting students from low-per-

#### **NOTES**

- 268.
- <sup>21</sup> CEA (2016).
- <sup>22</sup> Jacob P.K. Gross, Osman Cekic, Don Hossler and Nicholas Hillman, "What Matters in Student Loan Default: A Review of the Research Literature," *Journal of Student Financial Aid* 39 (2010): 19-29; Hillman (supra note 18).
- <sup>23</sup> Stephanie Riegg Cellini, Rajeev Darolia, "High Costs, Low Resources, and Missing Information: Explaining Student Borrowing in the For-Profit Sector," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), pp. 92-112.
- <sup>24</sup> Robert Kelchen and Amy Y. Li, "Institutional Accountability: A Comparison of the Predictors of Student Loan Repayment and Default Rates," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), pp. 202-223.
- <sup>25</sup> College Board (2016).
- <sup>26</sup> Beth Akers and Matthew W. Chingos. *Game of Loans: The Rhetoric and Reality of Student Debt*. Princeton: Princeton University Press, 2006.
- <sup>27</sup> Smith, Zakiya, "Exploring the Increased Role of Federal Executive Branch Policy-Making for Higher Education Through Lenses of the Policy Process," Unpublished doctoral dissertation, 2016.
- <sup>28</sup> Jason Delisle, "The Coming Public Service Loan Forgiveness Bonanza (Evidence Speaks Reports, Vol. 2, No. 2)," Brookings, September 2016.
- <sup>29</sup> The Institute for College Access and Success, *Student Debt and the Class of 2015* (October 2016). Available: [http://ticas.org/sites/default/files/pub\\_files/classof2015.pdf](http://ticas.org/sites/default/files/pub_files/classof2015.pdf).
- <sup>30</sup> Dustin Weeden, "Hot Topics in Higher Education: Student Loan Debt," National Conference of State Legislatures, 2015.



### BOX 1: STATE-BASED STUDENT LOAN POLICIES

The share of bachelor's degree graduates with loan debt and the average debt amount for borrowers vary widely by state, ranging from a low of \$18,900 in Utah to a high of \$36,100 in New Hampshire.<sup>29</sup> States have advanced a range of initiatives that may influence the effects of federal loan programs on student outcomes. States have proposed, and in some instances created, their own loan forgiveness and repayment plans (35 states), programs to refinance student loans (7 states), tax deductions and credits for student loan payments (e.g., Maine, Rhode Island), low- and no-interest loans (e.g., Massachusetts, Georgia), and child savings accounts (7 states).<sup>30</sup>

forming institutions, encouraging use of forbearance and deferment mechanisms, and strengthening income-driven repayment options.

#### 1. PROTECT STUDENTS FROM LOW-PERFORMING INSTITUTIONS

The U.S. Department of Education has few instruments for regulating or monitoring the higher education marketplace. The federal government has historically used cohort default rates as one criterion for institutional eligibility for HEA Title IV participation.<sup>32</sup> But because loan payments can be suspended through deferment or forbearance, loan default rates may understate the number of students who cannot afford to repay their loans. In an exploration using loans in negative amortization (i.e., where pay-

ments are smaller than accrued interest) as an alternative to the cohort default rate for measuring institutional performance, researchers found higher rates of non-repayment.<sup>33</sup>

These findings suggest that cohort default rates do understate the extent to which borrowers are experiencing challenges repaying their loans. Institutional characteristics that predict cohort default rates (e.g., shares of African American, first-generation, and independent students) are even stronger predictors of non-repayment. One strategy for facilitating repayment is to prevent institutions with low student loan repayment or completion rates from disbursing federal loans under Title IV of the HEA.<sup>34</sup>

Questions remain about the ideal approaches for measuring institutional

performance and using these measures to protect consumers. Proposed risk-sharing strategies include tying some form of penalty to institutional performance on metrics like loan default rates relative to a peer group.<sup>35</sup> Such strategies may protect students from risky loans and encourage improvements in institutional performance. On the other hand, they may also limit access for low-income and other historically underrepresented groups of students, at least for some colleges.<sup>36</sup> Some institutions may respond to high-stakes financial incentives by opting out of Title IV programs and/or gaming the metrics.<sup>37</sup>

The challenge of creating a policy that both protects consumers and preserves student access and choice is particularly salient in the for-profit higher education sector. Many researchers have voiced important concerns about for-profit institutions, questioning the implications of profit-maximizing motivations, heavy reliance of enrolled students on federal loans and Pell Grants, low average completion rates, and poor employment outcomes.<sup>38</sup> In response to concerns that some for-profit colleges were leaving students with large debts they were unable to repay, the Obama Administration introduced "gainful employment"

### NOTES

<sup>31</sup> Chapman and Dearden (supra note 21).

<sup>32</sup> Robert Kelchen, "Proposing a Federal Risk-Sharing Policy," Lumina Foundation, September 2015.

<sup>33</sup> Kelchen and Li (supra note 25).

<sup>34</sup> Sandy Baum, *Student Debt: Rhetoric and Realities of Higher Education Financing*, The Urban Institute, 2016.

<sup>35</sup> Kelchen (supra note 33).

<sup>36</sup> Hillman (supra note 11).

<sup>37</sup> Ibid.

<sup>38</sup> Cellini and Darolia (supra note 24).

<sup>39</sup> These regulations require occupational programs to

demonstrate that their graduates' loan payments are less than 8 percent of their earnings or 20 percent of their discretionary earnings to be eligible for federal financial aid. See: U.S. Department of Education (2015), *Fact Sheet: Obama Administration Increased Accountability for Low-Performing For-Profit Institutions*.

<sup>40</sup> "Income-driven repayment" refers to programs that use borrowers' income to determine repayment. Research generally uses the terms "income-based," "income-contingent," and "income-sensitive" repayment plans interchangeably, although the programs may be operationalized

differently. See: Chapman and Dearden (supra note 21), Shireman (note 47).

<sup>41</sup> Office of Management and Budget (2017), *Budget of the U.S. Government, Fiscal Year 2018: Major Savings and Reforms*. Available: <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/msar.pdf>.

<sup>42</sup> U.S. Government Accountability Office (2016), *Federal Student Loans: Education Needs to Improve Its Income-Driven Repayment Plan Budget Estimates*. [GAO] Available: <http://www.gao.gov/assets/690/681064.pdf>.

<sup>43</sup> College Board (2016).



rules.<sup>39</sup> The Trump Administration appears likely to revisit these rules.

## 2. STRENGTHEN INCOME-DRIVEN REPAYMENT OPTIONS

Income-driven repayment options may be effective in reducing the risk of default for individuals who have low earnings initially or over the course of their lifetime.<sup>40</sup> These options set monthly payments on a sliding scale based on income, with any outstanding balance forgiven after a defined repayment period. These plans allow students to borrow to pay for college costs, while protecting them against the risk that their investment will not pay off.

There are five income-driven repayment options, creating considerable complexity for students. One such plan, named REPAYE, sets payments at 10 percent of discretionary income, with any remaining balance forgiven after 10 years (for borrowers in public service jobs), 20 years (for borrowers of undergraduate loans who are not in public service jobs) or 25 years (for borrowers of graduate school loans who are not in public service jobs).

The Trump Administration has proposed eliminating all of the exist-

ing plans and creating a new one that sets payments at 12.5 percent of income, with any remaining balance forgiven after 15 years (for undergraduates) or 30 years (for graduate students). It would also eliminate the interest-free deferral offered low-income students while they remain in college. These changes would make the program more generous for some undergraduates, but would substantially increase debt burdens on public servants and graduate students and save approximately \$15 billion a year.<sup>41</sup>

Participation in income-driven plans has increased in recent years, rising from 10 percent of Direct Loan recipients in repayment in June 2013 to 24 percent in June 2016.<sup>42</sup> In 2016, 25 percent of all federal Direct Loan borrowers in repayment, and 43 percent of all federal Direct Loan dollars, were in an income-driven repayment plan.<sup>43</sup> Some researchers suggest that there may be benefits to enrolling at least some borrowers in an income-driven repayment program automatically, including reducing distress among low-income borrowers.<sup>44</sup> But efforts to increase participation in income-driven repayment should consider ways to reduce potential negative

consequences, including insulating students and colleges from the implications of excessive debt loads.

Increasing participation may have costs to taxpayers, depending on repayment schedules and participation rates. Correctly estimating the costs of income-driven repayment is difficult, given the uncertainty in forecasting rates of participation in income-driven repayment plans, borrowers' debt level, borrowers' incomes over a decade or longer, and interest rates.<sup>45</sup> ED underestimated the costs of income-driven repayment plans for Direct Loans made in fiscal years 2009 through 2016, largely because of the rising volume of loans in these plans.<sup>46</sup>

In addition to identifying sources to fund the costs of income-driven repayment plans, federal policymakers also should consider optimal approaches for administering the program. Unlike in England and Australia, student loan records in the U.S. are not automatically linked to the tax system and, consequently, borrowers in income-driven repayment plans must annually report their income to ED. Many researchers have proposed creating such a link in the U.S. Though this change would reduce the com-

## NOTES

<sup>44</sup> Chapman and Dearden (supra note 21).

<sup>45</sup> Wenhua Di and Kelly D. Edmiston, "Student Loan Relief Programs: Implications for Borrowers and the Federal Government," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), pp. 224-248.

<sup>46</sup> GAO (2016).

<sup>47</sup> Robert Shireman, "Learn Now, Pay Later: A History of Income Contingent Student Loans in the United States," *The ANNALS of the American Academy of Political and Social Science*, Vol. 671, Issue 1 (2017), pp. 184-201.



plexity of the current requirements for annual verification of income and would ensure accuracy of reported income, there is some speculation that this change might also reduce overall compliance with the tax system.<sup>47</sup>

## CONCLUSION

Student loans are a pillar of the United States' system of postsecondary education. While borrowing to pay for college remains a wise investment for most students, many students default

on their loans or make payments that are smaller than their accrued interest. To meet federal higher education goals in the United States, policies should ensure that students are well informed about loans and should protect students from the risks of unaffordable loans.

Policymakers can accomplish these goals, in part, by strengthening borrowers' protections against institutions and programs where they are unlikely to be able to repay their loans and by simplifying income-driven repayment

options currently available. Income-driven repayment and loan forgiveness programs tend to help borrowers repay and pursue careers, but they must be accompanied by protections against low-quality colleges to avoid imposing costs on taxpayers. For all of the uncertainty currently swirling around the higher education landscape, the reality of a growing and debt-burdened population of student loan borrowers must compel lawmakers and education officials to act decisively in the best interest of all Americans.



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As former deputy director of the White House Domestic Policy Council, James Kvaal oversaw the policy development

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