



# Increasing Postsecondary Attainment Through Smarter Student-Loan Repayment

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By Elizabeth Baylor and David Bergeron March 26, 2015

Center for American Progress



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# Introduction and summary

By the year 2020, nearly two-thirds of U.S. job openings will require postsecondary education, according to workplace projections by Georgetown University's Center on Education and the Workforce. Those projections show that 35 percent of jobs in 2020 will require a bachelor's degree and 30 percent will require an associate's degree or other education credential.<sup>1</sup> Based on current postsecondary education attainment levels, this data means that the U.S. economy will soon face a shortfall of 5 million college-educated workers.<sup>2</sup>

Meeting future workplace demand means significantly boosting the share of Americans who have attained high-quality postsecondary education degrees and credentials. According to the most recent data from the Organisation for Economic Co-operation and Development, or OECD, 43 percent of Americans have earned a postsecondary degree or credential, and of those same Americans, 32 percent have attained a bachelor's degree or higher.<sup>3</sup>

Today, the U.S. economy has \$1.3 trillion in outstanding student-loan debt; \$1.1 trillion of that debt is the result of federal loan programs with the remaining \$200 billion in student-loan debt coming from private lenders.<sup>4</sup> Outstanding federal student-loan debt equaled \$27,800 per borrower in 2014, which is up from \$18,300 per borrower in 2007.<sup>5</sup> The system of collecting federal student loans relies on servicers and collection agencies that have little incentive to prioritize the financial well-being of students because the cost of providing the service and the amount of loan debt collected drive the allocation of the portfolio. In addition, choosing a repayment plan is complicated because new plans have been layered upon each other over time.

The federal government must play a crucial role in increasing postsecondary education attainment, specifically by ensuring that American students have the financial resources needed to go to college and by minimizing the amount of debt they are required to take on. To address these challenges, the Center for American Progress recently released a new plan for the U.S. higher-education system, College for All. College for All would guarantee that every high school graduate would be able to attend four-year, public institutions without having to incur any

tuition or fees while enrolled. Students attending private schools would receive support equivalent to the cost of a public institution's tuition and fees. Graduates would be required to repay the cost of their tuition and fees, but repayment would be based on their income. Pell Grants and American Opportunity Tax Credits would be retained and targeted at the most at-risk students in order to cover the full cost of attendance or support their attendance at private institutions.

This proposal calls for modernizing the way student loans are repaid in order to promote affordability, eliminate default and its detrimental economic consequences, and reduce taxpayer costs. Ultimately, CAP proposes the creation of a new system that utilizes the Internal Revenue Service's, or IRS's, wage-withholding system to repay student loans automatically. This modern system would make all borrowers eligible for simple, affordable repayment terms based on income and employ modern data exchanges and smart strategies to help students proactively manage student-loan debt. Automatic loan repayment would be the default method of repayment under the new system; it would offer incentives to student borrowers to boost participation.

This report describes the elements of the universal wage-withholding system for student-loan repayment and outlines an implementation process that would allow the Obama administration to begin to pilot the system to ensure it works well. The pilot would begin by allowing federal workers with student-loan debt to repay some loans automatically and expand the pilot to workers in the private sector. If College for All were adopted, this model could be further streamlined to manage postsecondary education financing. Even without the expanded benefits of College for All, this new system of repayment would help borrowers by streamlining the process for repayment and expanding access to affordable repayment terms, minimizing their risk of default.

CAP proposes the following elements of the program:

- **Use the IRS's wage-withholding system to automatically repay student loans:** Congress should enact legislation to allow all borrowers with outstanding student-loan debt—including those with private loans and Federal Family Education Loan, or FFEL, Program loans—and new borrowers to automatically repay their loans using the IRS's wage-withholding system.

- **Provide simple, affordable repayment terms for all borrowers:** Ultimately, all federal student-loan borrowers who participate in this new system would be eligible for a single, simple income-based plan. Terms would be similar to today's Pay As You Earn, or PAYE plan, which caps monthly payments at 10 percent of discretionary income and allows for the elimination of any remaining debt after 20 years. Individuals who earn enough would amortize the amount owed in order to finish repaying their loans after 10 years, similar to today's standard repayment plan.
- **Share the savings:** Once phased in, automatic loan repayment through wage withholding would be the standard repayment method for workers with student loans, but existing borrowers would have the ability to opt out of the system if they preferred to retain their current repayment to servicers. Since wage withholding would be less expensive for the U.S. Department of Education to run than the current system of using third-party servicers and collectors, a portion of that savings could be shared with borrowers to create an incentive for them to participate.
- **Build a smarter system that proactively helps borrowers manage their debt:** The modern loan repayment system would optimize affordable loan repayment. It would use modern data exchanges within the federal government and private-sector partnerships to proactively help students manage their debt. In order to eliminate default and its grim economic consequences, borrowers with economic hardship would be proactively reassigned a monthly payment based on income in order to ensure affordable repayment. For example, if a borrower applied for unemployment insurance, information communicating this status could be shared between the U.S. labor and education departments, and the student would be reassigned a monthly payment—likely very low—based on the new income level.

This program would require legislative action in order to provide all borrowers with access to its wage withholding and to create incentives in the form of shared savings. Streamlining repayments terms would also require legislative action. The U.S. Department of Education could move forward with a pilot of the wage-withholding mechanism through the following:

- **Create a smooth transition to the new repayment system beginning with the federal workforce:** The Obama administration should use its executive authority to pilot an automatic student-loan repayment program within the federal workforce. The federal government would use existing payroll systems to calculate monthly payments and automatically credit student-loan accounts held by employees. Federal workers with bank-based FFEL loans could consolidate into the new program structure in order to take advantage of the wage-withholding system.

- **Partner with private-sector employers to allow borrowers to pay their federal direct loans through wage withholding:** Once the U.S. Department of Education has developed the capacity to direct wages to outstanding federal loans, it could engage private employers that would like to provide this service to their employees.

Together, these changes would make student loans more affordable and ensure that student borrowers are in repayment plans that promote both economic well-being and stability.

# Paying for college increasingly relies on student-loan debt

America's higher-education financing system has become increasingly dependent on student-loan debt. Data released by the U.S. Department of Education every four years provides detailed information on how students and families finance postsecondary education. During the 2011-12 academic year, 40 percent of undergraduates borrowed under federal student-loan programs to pay for their education; this was a marked increase from 35 percent in 2007-08 and 33 percent in 2003-04.<sup>6</sup> Among students who borrowed, the average amount borrowed in 2012 was nearly \$7,796, up 26 percent from \$6,201 in 2008 and up 44 percent from \$5,401 in 2004.<sup>7</sup> These figures each represent just one year of borrowing, so total borrowing levels for degree completion are likely to be substantially higher.

Paying for postsecondary education has become increasingly dependent on financial contributions from students and their families and on loans from the federal government. The cumulative amount of revenue that higher-education institutions received from tuition payments has increased yearly over the past decade. After adjusting for inflation, institutions of higher learning collected a total of \$101 billion in tuition revenue during the 2003-04 school year.<sup>8</sup> That amount increased yearly, eventually reaching \$155 billion during the 2012-13 school year, the most recent year for which data are available. Meanwhile, the amount of money that students and families borrowed to finance their education similarly rose. After adjusting for inflation, \$57 billion was borrowed from federal loan programs during the 2003-04 school year, an amount that increased to a high of \$107 billion during the 2010-11 school year. During the 2012-13 school year, the amount borrowed dipped slightly to \$100 billion, likely due to the improving economy.<sup>9</sup>

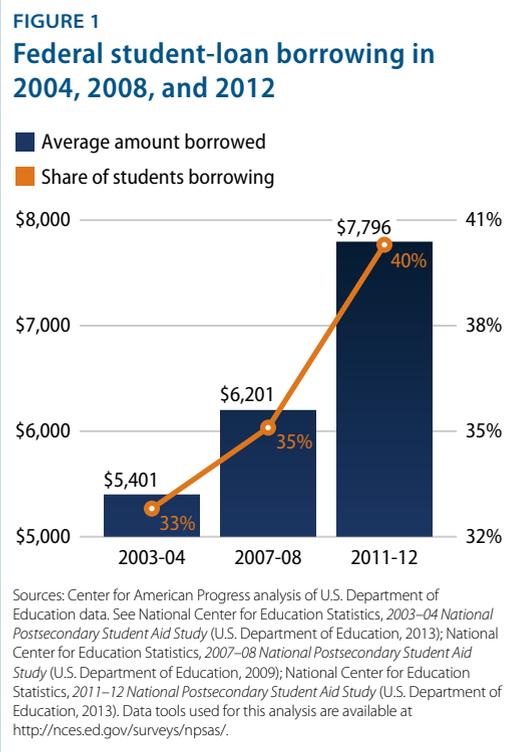
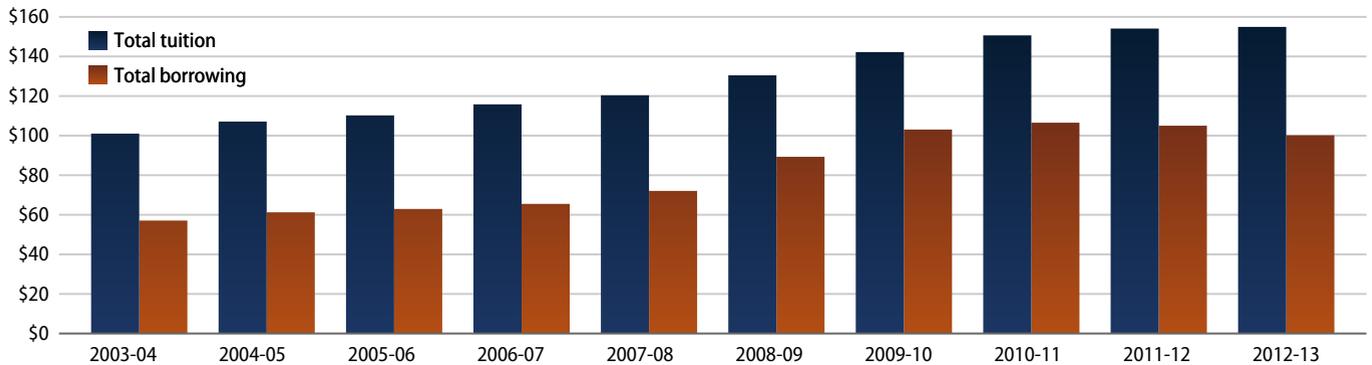


FIGURE 2

### Tuition payments and student-loan borrowing are increasing

Total tuition revenue and student-loan borrowing per year, 2003-04 through 2012-13, in billions of constant fiscal year 2012 dollars



Source: CAP analysis of U.S. Department of Education data. See endnote 8.

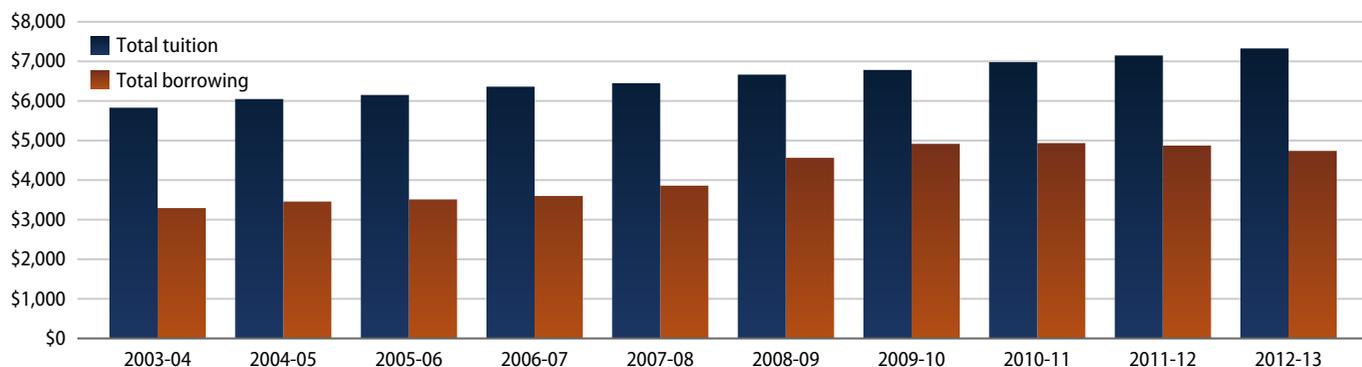
When examined on a per-student basis, the increases in tuition payments and federal student-loan borrowing look similar to the overall increases to both amounts. Over the period examined, from 2003 through 2013, the number of students enrolled in institutions of higher education increased: There were 17.3 million students enrolled in institutions of postsecondary education in the fall of 2003 with the number of students rising to a high of 21.6 million in the fall of 2011. As with the amount of loan borrowing, the number of students enrolled in postsecondary institutions dipped slightly to 21.1 million in the 2012-13 school year.<sup>10</sup>

Between the 2003-04 school year and the 2012-13 school year, tuition payments increased from \$5,829 per student to \$7,327 per student, an increase in tuition of \$1,498 per student. Over that period, the amount of borrowing per student similarly increased. In 2003-2004, borrowing from federal student-loan programs equaled \$3,293 per student, increasing to a high of \$4,935 per student during the 2010-11 school year and dropping to \$4,738 per student in 2012-13.<sup>11</sup> The change over the entire period equaled an increase of \$1,444 per student. Borrowing per student likely decreased in the most recent years in part because families started to recover from the impact of the economic recession that began in 2008 and thus had more personal financial resources.

**FIGURE 3**

### Tuition revenue and student-loan borrowing per student is increasing

Tuition revenue and federal student-loan borrowing per student, 2003-04 through 2012-13, in constant FY 2012 dollars



Source: CAP analysis of U.S. Department of Education data. See endnote 8.

### Some students are having trouble repaying their loans

Analyses of the student-loan portfolio track the increasing student-loan balances carried by Americans who have borrowed funds from programs authorized under Title IV of the Higher Education Act in order to attend postsecondary institutions. In fiscal year 2007, 28.3 million individuals owed \$516 billion in outstanding federal student loans.<sup>12</sup> By FY 2014, the number of borrowers increased 44 percent to 40.7 billion individuals, and the total amount owed more than doubled to \$1.1 trillion in federal student loans.<sup>13</sup> The Federal Reserve calculates that total student-loan balances equal \$1.3 trillion, including an estimated \$200 billion from private banks.<sup>14</sup>

**TABLE 1**

### Student-loan debt owed and loans in default are increasing

Fiscal year	Number of borrowers (in millions)	Total amount owed (in billions)	Amount owed in default (in billions)
2007	28.3	\$516	\$41
2008	29.9	\$577	\$47
2009	32.1	\$657	\$53
2010	34.3	\$750	\$61
2011	36.5	\$848	\$67
2012	38.3	\$948	\$79
2013	39.6	\$1,040	\$94
2014	40.7	\$1,130	\$105

Sources: Office of Federal Student Aid, *Federal Student Aid Portfolio Summary* (U.S. Department of Education, 2014), available at <https://studentaid.ed.gov/about/data-center/student/portfolio>; Office of Federal Student Aid, *Service Summit Loan Portfolio Briefing Document* (U.S. Department of Education, 2014), available at <http://fsaconferences.ed.gov/servicingsummit.html>. Document is available at the "Portfolio Overview" link.

There are signs that some student-loan borrowers struggle to repay their student loans. Data from the U.S. Department of Education show that a significant share of those in repayment do not make timely payments on their loans, instead relying on forbearances and deferments, or they simply become delinquent and ultimately default. Quarterly reports of the federal student-loan portfolio track the status of borrowers who are repaying their loans and show that a significant share of those loans are not being actively repaid. As of the fourth quarter of FY 2014, \$523 million in federal direct loans were in repayment; of that amount, \$216 million, or 41 percent, were in deferment, forbearance, or default.<sup>15</sup> There were also \$387 million in bank-based FFEL Program loans in repayment; of that amount, \$144 million, or 37 percent, were in deferment, forbearance, or default.<sup>16</sup> The Department of Education notes that the majority of deferments in both loan programs are education related.<sup>17</sup> At minimum, 27 percent of federal direct loans and 31 percent of FFEL Program loans are in economic distress.<sup>18</sup>

Default is the most significant economic status of nonrepayment, occurring after payment has not been made for at least 270 days.<sup>19</sup> As student-loan borrowing has increased in recent years, so has the value of student loans that are in default. In FY 2007, defaulted federal student loans equaled \$46.7 billion; since then, the amount has increased each year to \$105.4 billion in student-loan defaults in FY 2014. As a share of the whole portfolio, the student-loan default rate has remained steady; it equaled 8 percent in FY 2007 and 9.2 percent in FY 2014.<sup>20</sup>

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## Too many student-loan repayment options complicates repayment

In order to make repaying student loans more manageable and provide options for individuals with different financial circumstances, the federal government offers multiple repayment plans that vary in length of repayment, allow for graduated payments, and base the monthly payment on a borrower's income. However, each newly created plan is added to the existing complement of plans, making it increasingly complicated to navigate repayment. The system now counts seven separate repayment plans, all with different terms and eligibility guidelines.<sup>21</sup> In addition, there are benefits that allow students to repay a portion of their debt through service.<sup>22</sup> The advantages and disadvantages of each plan vary for individuals. However, student borrowers must be proactive and increasingly well informed in order to select the repayment plan that suits their needs. Below is a description of repayment plans and benefits available to federal student-loan borrowers.

- **Standard:** The standard repayment plan amortizes student-loan debt over 10 years. Interest rates are fixed, and this plan calculates a monthly payment based on the total principal and interest due, divided equally by 120 payments. The minimum payment for the standard plan is \$50 per month; if the loan balance is low enough that a student owes less than that minimum, they pay \$50 per month and repay their loans in less time. This repayment plan is the default plan. Today, student-loan servicers enroll borrowers in this plan unless they elect an alternate plan.<sup>23</sup>
- **Graduated:** Similar to the standard repayment plan, the total amount owed under the graduated repayment plan is based on a fixed interest rate. However, monthly payments are varied so that borrowers pay less immediately after leaving school. Monthly payments increase every two years over the 10-year repayment schedule. Over the course of repayment, a student pays slightly more interest than under the standard plan because less principal is paid in the beginning years.<sup>24</sup>
- **Extended:** The extended repayment plan uses a fixed interest rate and amortizes student-loan debt over a longer period—up to 25 years—resulting in lower monthly payments. Because less principal is paid each month, the total interest payments paid over the life of the loan can be significantly more than under standard repayment. In order to be eligible for extended repayment, borrowers must owe a minimum of \$30,000 in a given student-loan program. For example, a borrower who owes less than \$30,000 in direct loans and less than \$30,000 in bank-based FFEL Program loans but owes more than \$30,000 in total loans is ineligible for extended repayment.<sup>25</sup>
- **Repayment based on income:** For borrowers with direct loans, there are multiple repayment plans that establish monthly payments based on what the borrower can afford. Rather than basing student-loan payments on the principal balance plus interest, these plans calculate a monthly payment related to income. These plans are aimed at making student-loan debt more manageable by reducing the monthly payment for those in need. Under these plans, students are never required to pay more per month than they would under the standard plan. Interest continues to accrue based on the standard calculation, so students could pay more interest over the repayment period. Repayment continues beyond the 10-year window if a balance remains, and after a given time—between 20 years and 25 years—the remaining balance is forgiven. The three plans with different repayment terms and formulas are income-based repayment, or IBR; Pay As You Earn, or PAYE; and income-contingent repayment, or ICR. Students are eligible for each of these programs based on when they borrowed.<sup>26</sup>

For students who borrowed under the bank-based FFEL system, there is the income-sensitive repayment plan. This plan also bases the monthly payment on borrower income, but the monthly payment may increase beyond the standard 10-year amount if the student's income supports it. Lenders determine the formula to establish the monthly payment.<sup>27</sup>

## Earned elimination of student-loan debt

In addition to the many loan repayment plans, there are certain circumstances that allow borrowers with federal student loans to eliminate their debt through public-service or teaching employment. These programs complement repayment plans but require separate terms to be met in order to achieve the benefit.

Public Service Loan Forgiveness, or PSLF, allows some student borrowers enrolled in PAYE, IBR, and ICR to cease loan repayment after 10 years of on-time payments, regardless of what balance remains. People in jobs that serve the public good such as nurses, teachers, firefighters, and police; those employed by state, local, federal, and tribal governments; and those working for nonprofit organizations are eligible for this program.<sup>28</sup> The Consumer Financial Protection

Bureau estimates that 25 percent of the workforce is eligible for PSLF.<sup>29</sup> Workers must be employed full time to be eligible for debt elimination, thus ensuring that earnings are high enough to make significant student-loan payments. Borrowers are only eligible if they are enrolled in one of the income-related repayment plans described above. If a borrower repaid under the standard plan in 10 years, there is no balance left to forgive at the end of the period; graduated and extended repayment plans are ineligible.<sup>30</sup>

The Teacher Loan Forgiveness Program allows borrowers to eliminate up to \$17,500 in eligible federal student loans. To qualify, individuals must teach full time for five complete and consecutive academic years and serve designated low-income communities.<sup>31</sup>

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### Loan repayment that is affordable and encourages economic security

As reliance on individual contributions to finance postsecondary education increases and student-loan debt becomes an imbedded part of the system, loan repayment must be affordable. Repayment plans that are based on income are an important part of the economic compact related to education debt. For young adults who pursue education beyond high school, median incomes increase with each level of educational attainment. In 2012, among full-time workers ages 25 to 34, the median income for a person with a high-school diploma was \$29,960; for a person with an associate's degree, the median income was \$35,720; with a bachelor's degree, it was \$46,900; and with a master's degree or higher, the yearly

median income was \$59,620.<sup>32</sup> This general trend ensures that as students take on debt to pursue postsecondary education, most will benefit from economic returns that allow for smooth and affordable repayment. However, for borrowers whose incomes fall below the levels needed to sustain the repayment of their education debt, support with lower repayment terms should be available.

There are a significant and growing number of student loans in repayment plans that factor in income levels when calculating monthly payments. Summary information of take-up rates for repayment plans based on income—such as PSLF, IBR, and PAYE—demonstrate that many individuals benefit from these programs. According to data released by the U.S. Department of Education, \$135 billion of the \$478 billion in outstanding direct-loan balances in repayment were enrolled in a repayment plan based on income as of the fourth quarter of FY 2014.<sup>33</sup> This amount is equal to 28 percent of the direct-loan portfolio in repayment.<sup>34</sup> One year earlier in FY 2013, \$79 billion of the \$372 billion in outstanding direct-loan balances in repayment, or 21 percent, were enrolled in income-based repayment plans.<sup>35</sup>

The number of borrowers opting for these repayment plans is likely to increase significantly in the coming years as eligibility is expanded and more borrowers understand their benefits. Among repayment plans based on income, PAYE offers the most generous terms, including lower monthly payments and fewer years of payment before borrowers are eligible to have remaining debt eliminated.<sup>36</sup> In June 2014, recognizing the need to make repaying student loans more affordable for more borrowers, President Barack Obama announced plans to expand access to PAYE to 5 million more direct-loan borrowers.<sup>37</sup>

### Student-loan servicing is complicated, expensive, and inefficient

The proliferation of repayment plans is a result of successive attempts to improve upon prior models while making sure no previously enrolled borrowers lose eligibility for their plans along the way—however, this sometimes resulted in leaving those borrowers in less favorable plans. The multitude of options with discrete terms and often confusing eligibility parameters can make it hard for borrowers to identify the plan that best suits them financially. Moreover, repayment options have been added over time. The original standard repayment plan has been available since the program began in 1965.<sup>38</sup> Graduated and extended repayment were added in 1989, ICR was added in 1994, IBR in 2009, and PAYE

in 2012.<sup>39</sup> Eligibility for some repayment options is based on which type of loans were offered when the student borrowed or which program in which the student's institution participated: direct loans or bank-based FFEL loans.<sup>40</sup> Finally, as new repayment options are added, existing plans are retained for borrowers who have already enrolled. Together, this means that signing up for a repayment plan that best suits a borrower's economic needs and financial situation can be difficult.

In part because of the complexity of loan repayment and in part because borrowers may be unaware of plans that may make repayment affordable, student borrowers have sought relief from private entities that purport to help them avoid default or save money. A National Consumer Law Center, or NCLC, investigation examined this expanding student-loan debt-relief industry and found misleading practices, including entities mischaracterizing government programs as their own and charging fees for services that the federal government offers for free.<sup>41</sup>

Today, the U.S. Department of Education contracts with 11 private entities, both for profit and nonprofit, to conduct loan-collection services, requiring a significant outlay of the department's annual budget. President Obama's FY 2015 budget requested \$772 million to manage the collection and servicing of federal student loans. This request equaled 53.5 percent of the Student Aid Administration budget.<sup>42</sup> The president's budget request states, "As loan volume grows, the costs of servicing increase."<sup>43</sup> If the system were modernized so that the cost of servicing the loans was reduced, investments from the federal government could be better directed toward supporting academic progress, promoting student achievement, or lowering the cost of pursuing education rather than debt collection.

The system of collecting federal student loans by relying on servicers and collection agencies means that the entities that interact with students are not compensated in a manner that encourages both the servicers and collection agencies to ensure that students are enrolled in a plan that suits their financial needs. The compensation that these organizations receive is set through a competitive bidding process that drives toward the lowest possible cost for the government or lender. While the federal government has attempted to include the performance of the service or collection agency in the allocation of new accounts, such an approach still largely focuses on financial performance rather than on students and their needs.

Under the current loan-servicing system, contracted collection agencies subject borrowers who default on their loans to aggressive collection activities. The U.S. Treasury Department ultimately has the power to automatically garnish 15

percent of borrowers' wages, take federal benefits such as Social Security, and capture all of a borrower's tax refund in order to recover outstanding student-loan debt.<sup>44</sup> Today, these collection activities can only occur after an account has been delinquent for a significant amount of time—in this case, 270 days. Students in default face adverse consequences, including an additional 24 percent fee to their outstanding balance in order to cover the costs associated with collection, as well as an adversely affected credit rating.<sup>45</sup> This fee can be reduced or waived through negotiation, but a borrower must proactively seek a compromise. Borrowers in default are also eligible for loan rehabilitation that allows for re-entry into an affordable payment plan after good faith payments have been made.<sup>46</sup>

In a December 2014 audit, the Office of Inspector General, or OIG, found that the U.S. Department of Education's lack of a comprehensive strategy to address student-loan defaults meant that the department failed to improve the situation of students who were falling behind. Furthermore, this report found that some contracts with student-loan servicers did not outline default prevention activities, meaning some students received inadequate contacts from servicers.<sup>47</sup> The Obama administration agreed with the audit's recommendations to develop a plan to prevent student-loan default and to improve monitoring of default prevention activities.<sup>48</sup> In fact, has already begun to implement changes.

As part of its efforts to improve the servicing of federal student loans, the Obama administration has made considerable effort to ensure that it is studentcentric and that borrowers are protected from abusive practices. In February 2015, the administration announced it would end certain contracts with five private student-loan collection entities—because it found they provided misleading and inaccurate information to borrowers—and improve guidance and monitoring of other collection entities to ensure fair practices.<sup>49</sup> In March 2015, President Obama announced the creation of a student aid bill of rights. This pledge would ensure that “every borrower has the right to quality customer service, reliable information, and fair treatment, even if they struggle to repay their loans.”<sup>50</sup> In particular the administration aimed to raise the standards of student-loan servicing to ensure that students who fall behind are charged reasonable fees and that they receive help returning to good standing on their loans.

While welcome and necessary, efforts to improve servicing and protect student-loan borrowers who have defaulted are ultimately reactive. Student borrowers are required to wade through a complex system to figure out the repayment plan that best suits their financial needs; borrowers are not consistently eligible

for the same repayment terms; and if they fall behind, borrowers face grim economic consequences before they get back on the path to repayment. The detrimental economic consequences of failing to repay student loans are considerable. For example, in a modern economy, a poor credit score can affect other facets of borrowers' lives: It can negatively affect a borrower's ability to obtain credit, finance a home, and, in some circumstances, get a job.<sup>51</sup> The collection of student loans should be redesigned to ensure that repayment is affordable and provides protections for those with economic hardship. But, at its heart, it should be proactive so that student borrowers face clear, equal repayment terms and receive assistance before they fall behind.

# Recommendations

Congress should enact legislation to modernize repayment of student loans in order to lower the cost of servicing student-loan debt, as well as make it an easy option for borrowers to elect to repay their loans based on income. This proposal would require Congress to enact legislation to allow all borrowers to participate in a wage-withholding system and to streamline the repayment options. The U.S. Department of Education could pilot the wage-withholding aspect of the proposal by allowing federal employees to participate voluntarily and work with private employers that seek to use wage withholding on behalf of their employees to repay federal student loans.

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## Use the IRS's wage-withholding system to automatically repay student loans

Modern loan repayment would use the IRS's wage-withholding system to enable borrowers to repay their loans automatically. The wage-withheld repayment system would require borrowers to be responsible for their education debt while offering repayment terms that make loans affordable.

Under the modern loan repayment system, the IRS would receive funds from employers on behalf of their employees with outstanding student loans. The IRS would transfer the payments to the U.S. Department of Education to repay the borrower's student-loan debt. Once the funds are received by the Department of Education, the borrower's account would be updated to reflect the payment with the collection process stopping automatically once the borrower's loan is fully repaid or the balance is discharged. This approach is similar to how Social Security tax payments are handled today.

Borrowers would be automatically enrolled into repayment through the wage-withholding system, and ultimately, all new loans would be repaid through this system. Savings stemming from the lower administrative expenses would be shared with borrowers in the form of reduced interest rates. In the transition to the new system,

borrowers with existing debt could opt out of the wage-withholding system and continue to repay their loans through their existing servicers. Those borrowers would not participate in shared savings given the increased cost of servicing their debt.

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### Simple, affordable repayment terms for all borrowers

Repayment terms under modern loan repayment should be affordable and clear. When fully phased in, the system would make all borrowers with federal student-loan debt eligible for a single repayment plan based on income that is affordable and tracks progress toward elimination of debt. Repayment terms offered under the new plan would be similar to those offered today under Pay As You Earn. PAYE requires monthly repayments equal to 10 percent of discretionary income, or income above the poverty line. After 20 years of on-time payments, the remaining debt is eliminated. Borrowers with sufficient earnings would make monthly payments equal to today's standard repayment plan, amortizing the debt in equal monthly payments over 10 years.

The new repayment system should also ensure that professionals in jobs that serve society—teachers and public-service employees—are able to have any remaining balance on their loans forgiven after 10 years of automatic or on-time payments. Today, this program requires eligible borrowers to proactively seek the benefit and document their work in a qualified position. Using IRS wage withholding to manage student-loan debt would allow the program to automatically track borrower progress toward Public Service Loan Forgiveness by matching employer information to establish eligibility. Borrowers would receive periodic updates with their progress listed.

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### Share the savings to incentivize participation

Once fully implemented, all student borrowers would be defaulted into in the wage-withheld repayment plan. They would receive a discount on their interest rate equal to one-quarter or one-half of a percentage point, or 25 basis points to 50 basis points. During the transition to the new system, borrowers with outstanding loans could opt to retain their current servicer but would not receive the discounted interest rate. Individuals currently enrolled in an existing repayment plan based on income, such as PAYE or IBR, who have made payments credited toward

the elimination of debt would have those months of payment converted to the new income-based repayment program contemplated under this proposal. This provision would hold the borrower harmless from having to start at the beginning of the repayment period when converting to the new system and, for some, could lead to a shorter repayment window.

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### Build a smarter system that proactively helps borrowers manage their debt

Under the new system, borrowers would be automatically enrolled into repayment plans based on income. These plans allow people who have particularly low earnings to stay current on loans while making progress toward forgiveness. This safety net for low repayment is a key element that makes automatic repayment fair. Proactive intervention would mean that fewer individuals would face the truly devastating economic consequences that come with student-loan default.

The U.S. Department of Education should also partner with other federal agencies to create automatic triggers to identify borrowers who may struggle to repay. Currently, the Department of Education has interagency agreements to share information about students participating in federal student aid programs, including efforts to locate borrowers who have defaulted on their student loans.<sup>52</sup> These data-sharing efforts could be harnessed to proactively ensure that borrowers have monthly payments that suit their financial situation. For example, if a student borrower applied for unemployment insurance, information communicating this status would be shared between the U.S. labor and education departments, and the student would be reassigned a monthly payment—likely very low—based on the new income level. The student could continue to pay the previous monthly amount, but the default action would proactively lower the payment. Similarly, if a student borrower began a new job with different earnings, modern information exchanges, including the National Directory of New Hires, would help keep monthly payments in line with current income. The federal government also makes payments to individuals, either directly or through state intermediaries, when they face economic hardships, including unemployment and disability. These types of payments could also trigger a borrower in this repayment plan being automatically assigned—with an opt-out option—a lower monthly payment to prevent a borrower default.

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## Expand eligibility for automatic repayment and PAYE-like repayment terms

Congress could expand access to wage withholding and the new streamlined repayment terms to all federal-loan borrowers—both direct loans and outstanding bank-based FFEL loans—as well as those with private loans. Today, borrowers with existing FFEL and private loans are only eligible for repayment plans based on income if their lender provides that option.<sup>53</sup> Students with these loans could consolidate their outstanding student-loan debt and opt to participate in the new wage-withholding system so they can make just a single recurring payment. Under this proposal, borrowers who consolidated could also qualify for repayment based on income. As described above, previous on-time monthly payments would be counted toward economic-hardship and public-service debt elimination in order to incentivize participation. Private student-loan debt would need to be treated carefully to ensure that the balances ultimately eliminated do not expose federal taxpayers to excessive risk.

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## Create a smooth transition to the new repayment system

An automatic loan repayment is a significantly different method of repaying student loans than the current system. For this reason, CAP believes that piloting the system would be an effective means of ensuring it works well for borrowers, employers, and the administrators of the loan program.

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## Pilot the new repayment system within the federal workforce

The U.S. Department of Education should pilot automatic loan repayment through wage withholding for federal workers who have outstanding direct loans. Borrowers could also include outstanding FFEL loans if they choose to consolidate their loans through the Direct Loan Program. During the pilot, federal workers could opt out of wage withholding and choose to continue with their existing servicer.

The federal workforce is an ideal entity to begin the use of wage-withheld student-loan repayment because it is large and includes workers with a variety of incomes, many of whom have postsecondary degrees and credentials. By the very nature of employment, federal workers—who may also be student-loan borrowers—are familiar with interactions and information sharing with the federal government.

Currently, the federal government utilizes a few agencies to build and maintain the systems that pay federal employees across the government. These agencies have already developed the capacity to withhold a portion of an employee's income for a variety of purposes, including health insurance, charitable contributions, and savings allotments. It would be fairly straightforward for these payroll agencies to build the capacity to deduct loan payments from federal employees' paychecks. Some agencies provide workers with student-loan repayment assistance, typically as a recruitment tool. These awards would be maintained as part of the new repayment system.

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### Expand the system to workers in the private sector

Once wage-withheld repayment has been piloted within the federal workforce, the U.S. Department of Education could offer to support repayment through wage withholding to private employers seeking to provide their employees this benefit. The Obama administration has announced partnerships with private tax-preparation entities to ensure that workers know about student-loan repayment options.<sup>54</sup> Likewise, partnerships with large payroll administrators could ease the transition to wage-withheld student-loan repayments. Similar to the federal government, there are a small number of companies that perform the function of pay agent for private companies and nonprofit organizations. Once the capacity to receive payments through wage withholding is built, the federal government could share this capability with pay agents so that they could provide the service to their customers, making it possible for private-sector employees to pay through wage withholding. Since private-sector employees are more likely to face disruptions in employment, providing this type of service would be even more important than for federal employees.

# Conclusion

Individual and family contributions in the form of tuition and fees are a significant portion of the financing of postsecondary education, which is critical to maintaining America's economic competitiveness in today's modern economy. Federal student loans provide individuals and families with a significant portion of the financial resources necessary to pursue education after high school. However, in order to support the nation's education attainment goals, the United States urgently needs to modernize the way student loans are repaid in order to ensure that they remain affordable.

CAP proposes piloting and developing a wage-withholding system within the federal workforce to transition to this modern system. The goal would be to ease the burden of student-loan repayment, minimize delinquency, and eliminate default. Once established, this new system would be expanded to include other workers outside the federal labor force. In particular, this system would promote a repayment plan that is based on income under terms that are generous for the borrower. Importantly, modernization would make loan repayment simple and easy while improving Americans' financial situation.

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## About the authors

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