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Can a Default Option Reduce Default Rates?

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Can a Default Option Reduce Default Rates?

Income-Based Repayment Policies & Federal Student Loan Default Reduction Strategies

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Executive Summary

Starting in 2008, major changes to the federal student loan system have increased the generosity and flexibility of repayment options. In theory, these efforts should reduce the effect of the business cycle on default patterns. However, since 2007, student loan default rates have persisted in rising. In response, several student loan advocates have proposed replacing the standard program with the income-based repayment program as the automatic repayment option.

This stakeholder analysis explores the potential of this proposal from the perspective of borrowers, academic institutions, and student loan servicers through a literature review of empirical research of student loan default behaviors, quantitative analysis of cohort default rates, and exploratory interviews. This research does not strongly support the broad statement that automatic enrollment in income-based repayment would eliminate the problem of student loan defaults. However, of all repayment options, the income-based is best suited to meet the needs of financially stressed borrowers, and the stakeholder analysis uncovers some practical opportunities to leverage current infrastructures and institutional needs to improve outcomes.

This analysis recommends that the Department of Education consider piloting two default reduction efforts in order to promote income-based repayment programs: (1) partner with schools that have the largest number of associated defaulted loans to develop targeted counseling services prior to loan disbursement and (2) partner with servicers to test the effectiveness of making the income-based repayment program the automatic option upon entering into repayment. Though the income-based repayment program will not fully solve the problem of the rising burden of student loans, it provides a promising structure to reduce the financial burden of higher education debt.
Problem in Context

Too many student loan borrowers have gone into default, though the policies around repayment make default largely avoidable. Following targeted legislation in the early 1990’s to hold schools accountable for student loan default rates and increase repayment flexibility, annual measurements of two-year default rates showed a consistent downward trend, reaching a low of 4.9% in 2003 (Chart 1). However, since 2008 default rates have risen 75% to an alarming 9.1%.\(^1\)

Even more troubling, the Department of Education (ED) estimates a total lifetime default rate of 23%,\(^2\) and some analysts worry that ED has underestimated these rates and the related costs.\(^3\) Defaulted loans increase the cost to the government of providing a federally guaranteed student loan program. Furthermore, they result in higher costs to the borrower in the form of collection fees, marred credit scores, and garnished paychecks and tax returns.

**Chart 1 – Two-Year Cohort Default Rates by Year Measured (1989-2012)**

The dollar value of outstanding loans has increased by 62% in the past decade, amounting to $864 billion in aggregate debt.\(^4\) This combined with higher default rates has led to increased concerns in the media about the “student loan bubble” and its potential to ignite the next American financial crisis and/or hamper economic recovery. For example, lower rates of

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1 Baum & Payea. *Trends.* (2012), 20
home purchases by thirty to forty-year-olds suggests that young adults are over-leveraged and delaying major “life” expenditures, which are also traditionally drivers of economic recovery.\(^5\)

Although the correlation with the recession suggests that the problem of default is primarily economic, the theory behind the current federal repayment policies should effectively insulate federal loans from economic downturns. Since 1993, Federal Direct Loans have qualified for repayment programs based upon income, offering repayments as low as $0 and forgiveness after twenty-five years of keeping loans in good standing. The program did not initially cover the Family Federal Education Loan Program (FFELP), which promoted student loans origination by private banks through federal guarantees, and so had limits to the relief it could provide. Passage of the Income-Based Repayment (IBR) program in 2007 and subsequent additions of even more generous policies extended access to these repayment options to FFELP loan holders. (See Appendix I for comparisons between various repayment options).

It is difficult to say whether the programs reduced the impact of the recession on student loan default rates. However, their correlated rise with the financial crisis strongly suggests that the program has not yet broken the connection between economic conditions and student loan default. Several problems in implementation plagued IBR in its early days, such as accidentally omitting it as an option on the Financial Student Aid’s website\(^6\) and unexpected servicer transfer problems.\(^7\) Notably, Inside Higher Ed reported last year that, although over 5.4 million Americans were delinquent on their student loans, only 1.6 million had enrolled in IBR and only another 447,000 in the income-contingent program. This gap suggests the program has not yet reached many who could benefit from it.\(^8\) Furthermore, due to rising levels of enrollment, tuition,

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\(^5\) Brown & Caldwell. “Student Loan Borrowers Retreat” (2013)
\(^6\) Field. “Glitch May Block Student Borrowers” (2009).
\(^7\) Wang. “Student Loan Borrowers Dazed.” (2012)
\(^8\) Nelson. “Despite Student Debt Concern.” (2012)
and borrowing limits, loan servicers are preparing for Federal Direct programs to rise by 9% over the next three years, increasing the urgency of the default problem.\(^9\)

In response to mounting student loan pressures and the apparent gap in IBR enrollment, several education-related think tanks, including the CollegeBoard, The Institute for College Access & Success, American National Consumer Law Center, and the Association of University Women, have endorsed enrollment in IBR programs as a key strategy reducing default rates.\(^10\) Some, such as the Committee for Economic Development and Young Invincibles recommend that the IBR become the default repayment option upon entering repayment, ensuring that students would not bear unreasonable hardship due underemployment post-graduation.\(^11\)

While this recommendation appears to be a logical next-step, the theory of its effectiveness and feasibility rests on several assumptions that deserve further analysis: (1) the change would effectively target and help the population most prone to student loan default and (2) the incentive structures of major stakeholders would lead to the desired outcomes. This analysis attempts to shed light on these two assumptions, as well as assess if different strategies are necessary based upon loan type or systematic differences between segments in the repaying population.

**Methodology**

I approached this analysis as an operational problem, beginning with preliminary investigations into the various inputs, conducting some initial stress tests, and determining the areas that merit further consideration. The three major inputs I considered were (1) borrower needs, (2) institutional drivers of default, and (3) incentives of student loan servicers and

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educational institutions in administering federal student loans. I also expanded the definition of “income-based repayment” (IBR) to include all of the repayment programs that meet two criteria: no lower limit on monthly repayment amounts and loan forgiveness at some point in time. Thus, “IBR” in this analysis should be read as a loose definition of program requirements.

**Borrower Needs Assessment**

Current news articles and research from think tanks studying higher education and/or financial products informed much of this analysis, particularly in determining variations in student loan borrower characteristics and potential implementation problems. This analysis includes information gathered from seven news stories and thirteen reports/press releases from think tanks. To determine risk factors that lead to default, I reviewed scholarly journal articles from related disciplines including economics (five articles), education (seven articles), and public policy and management (one article) found via Google Scholar, JStor, EconLit, WorldCat, and ProQuest. I also conducted interviews with professionals that work with borrowers of government subsidized loans, including Nieve Santana, Associate Director of Processing Services at the University of Massachusetts-Amherst, Alice Graulty, Match Savings and Cash for College Coordinator at Foundation Communities in Austin, TX, and Jacki White, Loan Fund Manager at Neighborworks Housing Services in West Rutland, Vermont.

**Analysis of Schools**

The Operations Performance Division (OPD) under the Federal Student Aid division publishes two-year cohort default rates annually. Although this is the most consistent set of publicly available data, it has inherent limitations:

- Each cohort year reflects a new group of students.
- The data reflect the last school the student attended.
- Students entering repayment includes graduates and dropouts.
Thus, my analysis of the two-year cohort default rates considers the limitations of the data.

Given the categorical nature of analyzing default rates by school type, I sought to answer two questions: (1) Are there certain types of schools driving the increase in total default rates? (2) What is the approximate severity of a school’s default rate if you consider the average size of the loan and the percentage of students who borrow? For this analysis, I combined ED’s official default rates with data published by the Consumer Financial Protection Bureau (CFPB) in 2012.

For comparison purposes, I used rates measured in 2002 for the 2000 two-year cohort, which marks the beginning of a fairly stable period and the most recent 2012 measurement of the 2010 cohort. Noticing a tremendous increase in the number of students enrolled in the University of Phoenix, I recoded the for-profits with the largest repayment cohorts as “Ten Largest For-Profits” (see Appendix II for the list of schools). Since the data also lumped together public schools with a wide range of program lengths and the literature suggests that community college default patterns significantly differ from four-year institutions, I recoded all public institutions that did not offer bachelor’s or master’s levels programs as “Community Colleges.” These labels are not mutually exclusive, as schools often have many types of programs.

**Analysis of Student Loan Servicers**

For an incentive analysis of the student loan servicers, I looked at three of the four servicers for organizational analysis: Nelnet, Sallie Mae and Pennsylvania Higher Education Assistance Agency (PHEAA). I excluded Great Lakes because they did not publish an Annual Report accessible online. Of these I focused more heavily upon comparisons between Sallie Mae and PHEAA because they provide strong contrasting models and because of personal access to their customer service system. I called these servicers many times with questions regarding details of the programs and cross-checked answers. The organizational analysis also includes an
assessment of the servicer’s Direct Loan Servicing contract with the ED compared against revenue potential and risk, as expressed in annual reports to shareholders.

For a “snapshot” of current performance, I developed four questions about IBR options, all informational in nature, starting with general questions and ending with more complex. To improve the reliability of this measurement, I recruited classmates who have loans with various other servicers to call and ask these questions. Six participated and the survey covers all of the major Direct Loan servicers.

Potential Effectiveness of Income Bases Repayment as Social Insurance

In his first address to Congress, President Obama set a goal to make United States the world leader in producing college graduates per capita by 2020.\textsuperscript{12} Since 2002, college enrollment rates have increased by 34\%, although graduation rates are less than 60\%.\textsuperscript{13} This suggests that many Americans are realizing the need to enroll in higher education, but are leaving before benefiting from a degree, leading to debt without better credentials. IBR programs reduce the risk of taking out student loans, acting as a quasi-social insurance plan against crippling financial hardship.

Like traditional social insurance, the plan one would rationally choose depends upon the borrower’s expectations for future financial health. Unlike social insurance, once ED pays the direct loan to the school, all subsequent cash flows move in the direction from the borrower to the government, and the individual bears the burden of delayed cash flows in the form of accrued interest. To qualify for the most generous and newest IBR program borrowers must demonstrate that annual payments under the standard repayment plan would be more than at least 10\% of

\textsuperscript{12} U.S. Department of Education. Strategic Plan (2010) 1
discretionary income, taking into account family size. For a borrower in the first year of repayment with $20,000 of debt, the annual salary threshold for qualifying for IBR is $40,000, and for $100,000 of debt, the income threshold jumps to $150,000. This demonstrates that the programs are generous in their scope of targeted participants.

Chart 2: Comparison of Payment Outcomes Between Plan

<table>
<thead>
<tr>
<th>Repayment Plan</th>
<th>Years to Repay</th>
<th>Monthly Payment</th>
<th>Total Paid in Addition to Principle</th>
<th>Balance Sheet Forgiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>10</td>
<td>$345</td>
<td>$13,470</td>
<td>$0</td>
</tr>
<tr>
<td>IBR</td>
<td>20</td>
<td>$106</td>
<td>(2,652)</td>
<td>54,887</td>
</tr>
<tr>
<td>IBR +$20,000 Income in Yr 5</td>
<td>20</td>
<td>Yr 1-5: $106</td>
<td>Yr 6-20: $273</td>
<td>6,796</td>
</tr>
</tbody>
</table>

Note: Monthly payment determined by MyFedLoan.org’s Repayment Schedule Estimator. Based upon unmarried student with no dependents with $30,000 in debt at 6.8% interest rate and stagnant income of $30,000.

As Chart 2 shows, there is great variation in the amount of money a borrower might actually pay according to the payment plan and their career path. In this stylized example, the borrower took out $30,000 in Direct Loans, has a job with a stagnant income, and has no change in family status. The monthly IBR payment is a third of the payment under the Standard Plan, allowing for greater monthly flexibility in repayment. If nothing changes financially for this borrower, the public insurance kicks in after twenty years of consistent repayment, forgiving $2,652 of the original principle borrowed, a $15,132 nominal subsidy when compared to the borrower who stayed in the standard program. However, because of the nature of interest accrual, if the same student enjoys a major promotion in year five and only pays the minimum balance each month, s/he winds up paying more twice the amount as the standard borrower.

This variation in the amount borrowers might actually pay is not unique when comparing repayment plans, even under the old structures. Yet, this scenario illustrates that rational choice

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14 With a measurable discount rate, the additional years of repayment make the total payment under IBR consistently below that of the Standard Program because it is spread across more time (see Appendix III). However, in a situation where income is stagnant, the nominal effect will be more tangible to the borrower. Furthermore, communications between borrowers and servicers are presented in nominal values.
between repayment options depends upon predicting future job prospects. The potential for moral hazard looms for individuals with high preferences for expensive education and low preferences for high income. However, the future is inherently unpredictable, especially when people are over-leveraged and have only a small monetary buffer to counter financial emergencies. Within empirical studies, characteristics leading to an increased likelihood of default include age, race, parental marriage status and income, borrower’s income, degree completion, marital status of the borrower, and number of dependents. Although the significance between these characteristics varies, the story they tell is that borrowers are more likely to default if they have less access to gainful employment, fewer resources to rely on in case of financial emergencies, and more pressure to choose between uses of disposable income. Since these studies are based primarily on data from the 1980’s and early 1990’s, they may underestimate the degree to which the average American is vulnerable to financial hardship. By the early 2000’s the 75% of the average household income was dedicated to fixed monthly costs, making families particularly vulnerable to exogenous budget shocks and bankruptcy. However, since student loans can very rarely be forgiven in bankruptcy, they create a particularly sticky commitment for individuals experiencing financial hardship.

One of the potential gaps in IBR programs is that it does not extend to the Parent PLUS program. Although PLUS loans are considered less risky because they require a credit check, parents can borrow up to the difference between student federal loans/grants and tuition and the

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15 On the public good side of this equation, borrowers who wish to go into low salary public service work may benefit from the 2008 Public Service Loan Forgiveness program, which forgives student loans after ten years of documented work in the public sector. On the cost side, variation in total repayment makes the financial stability of the system unclear. Some experts worry that ED undervalues these costs by as much as $300 billion (Howes, 2012)
17 The ability for researchers to gather and use national-level datasets have presumably been hampered by Section 135 of the 2008 Opportunity and Affordability Act which prohibits ED from developing National Student Loan Database System for any purposes beyond traditional administrative uses.
application does not require evidence of ability to repay. Student loan borrowers over fifty years old held nearly 17% of the outstanding past-due balance in 2012 and represent the fastest growing age group for student loan debt.\(^{19}\) A mixture of factors are likely driving this change including the possibility that parents may be shifting the financing of their children’s education away from private loans and towards federal loans (which would ultimately be an accounting change), increased school enrollment by older students, and increased borrowing due to the higher cost of school. Nonetheless, those in this population with PLUS loans have very limited access to flexible repayment programs, even though they may have some systematic vulnerabilities due to health problems or large fixed expenses.\(^{20}\)

The tradeoff between flexibility and the long-term cost of the program is an old discussion in student lending. In a study from 1977, surveyed students at University of Pennsylvania preferred the idea of the twenty year repayment plan until they saw the total interest they would have to pay according to the repayment schedule. At that point they reverted to preferring the standard plan.\(^{21}\) Although this seems to favor the status quo, the study also shows that students were able to choose the more responsible payment amount when presented with the outcomes.

This idea could be very useful in choosing the best implementation options today. In a recent survey by the Young Invincibles, 60% of recent graduates said that they were “surprised by the terms of their loans or the student loan process” and 40% claimed had not receive exit loan counseling before leaving school.\(^{22}\) This may be an overestimate, since exit loan counseling

\(^{19}\) Cooper. “An Educated Mess” (2012), 1. Notably, the author also points out that the over-50 population is less likely to pay back student loans because of fewer remaining working years. The budgetary cost-benefit of the IBR program is beyond the scope of this paper, but worthy of further consideration.

\(^{20}\) Parent PLUS loans grew by 40% since 2008, while private loans decreased by 33%, suggesting that some of the change might be due to shifting sources for additional college funding. (Data from Baum, Trends, 2012)

\(^{21}\) Brugal. “The Demand for Student Loans” (1977), 81

\(^{22}\) Mishory & O’Sullivan. Student Perspective. (2012), 13
can require as little as an online quiz that students may click through. However, these numbers also highlight that most students do not have a full understanding of the terms that they are agreeing to before borrowing student loans and are unpleasantly surprised when the first payment comes due. Furthermore, the survey showed that 89% of respondents strongly agreed that the IBR program should be the automatic repayment option when they started paying back their loans, suggesting that recent graduates currently desire more flexibility.\textsuperscript{23}

Although there is no empirical research on repayment structures’ effect on default rates, a recent theoretical model suggests that flexibility in repayment amounts and locked-in interest rates are key factors in reducing default rates.\textsuperscript{24} This also implies that increased complexity might have negative consequences, even if the complexity may mathematically add to a less expensive outcome overall. The combination of eight repayment options available for three or four types of loans—often spread out amongst multiple servicers—creates a scenario that is ripe for lower engagement due to choice fatigue. Following a “paternalistic libertarian” model founded in behavioral economics, we would want to simplify options and encourage the optimal solution for the student and society.\textsuperscript{25} However, it is also important to consider whether the population that drives changes in default rates require specific outreach efforts.

**Primary Drivers of Default Rates & Targeting Strategies**

Although the intuition behind the student loan system largely assumes that borrowers are youth with little to no credit history, the University of Phoenix’s parent company noted in their 2012 annual report that they estimate that 73% of students were “non-traditional.”\textsuperscript{26} This large

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\textsuperscript{23} Ibid. 15
\textsuperscript{24} Ionescu “The Federal Student Loan Program” (2009) 226
\textsuperscript{25} Behavioral economic concepts from Thaler & Sunstein. *Nudge* (2009)
\textsuperscript{26} Apollo Group. *Annual Report*. (2012) 7
proportion of non-traditional students further suggests that the theory behind default reduction efforts should not assume that the target population is twenty-three year old college graduates.

By breaking down the change in defaulters over repayers by school type between 2000 and 2010 (see Appendix IV for calculations), we see that the ten largest for-profit institutions account for 41% of the total 3.75% increase over the past decade (Chart 3). When combined with other 1866 proprietary schools, for-profits account for over 68.3% of the increase in default rates, followed by publicly funded community colleges, which account for 22.8%. All of the two-year cohort default rates reflect low estimates of actual default and may bias these numbers towards populations that may default early during the lifetime of the loan. However, the two-year cohort measure likely underestimates default rates for for-profits. In 2012, the U.S. Senate Committee on Health, Education, Labor, and Pensions found that many for-profit operations have committed “significant resources to sophisticated operations that keep students out of default for the duration of the 2-year (and now 3-year) monitoring window by aggressively signing students up for forbearance and deferment.”

Nonetheless, the power of these top ten schools in driving up default does not lie in the default rate change, but in the overall increase in enrollment in that sector. Enrollment in for-profit institutions has increased by

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27 All two-year default rates should be considered to be a low estimate. In a 2006 longitudinal study of the 1993 Cohort, Susan Choy and Xiaoje Li found that student loan default rates peaked at four years and that 33% of borrowers were still repaying after ten years. Of those still making payments, 11% were paying more than $250 per month (Choi & Li, 2006).

more 450% over the last decade, compared to 30% for 4-year public institutions and non-profits. Unfortunately, the schools with the largest gains also have the lowest 6-year graduation rates of 22%, compared to 55% for public institution, further underscoring that much of the increase in student loan defaults is unaccompanied by increases in degree-attainment. The increase in enrollments seen by all school types suggests that the for-profit market has not cannibalized more traditional programs, perhaps providing accessible options to students in a time when the recession has ignited demand for higher education. All of the schools included in the “top-ten” have online programs, and presumably a large portion of the increase of enrollments is connected to these offerings. More recently, enrollments have started to decline. University of Phoenix cites the adverse publicity stemming from increased scrutiny in the media and by the government as a likely cause, though they also may be reaching market saturation.

As striking as these numbers are, empirical research does not support the conclusion that entering a for-profit institution increases an individual’s chances of defaulting. Once employment, income, graduation status, and race are included in a multivariate regression analysis, none of the empirical studies reviewed for this analysis showed a statistically significant relationship between institution type and default. However, cause-effect relationship between school-type, graduation rates and future employment is still unclear, lending to an active debate as to whether institutions should be held accountable for their default rates. Some studies have shown that increased support of students in school reduces default rates, while others suggest the opposite. A 2010 study by the independent think tank, Education Sector, finds that

29 Edmiston. Student Loan (2012), 12.
30 CollegeBoard. Education Pays. (2010), 42
34 Knapp & Seaks. “An Analysis” (1992), 406
schools’ student-faculty ratios consistently predicted lower default rates after disaggregating populations by school-type, suggesting that context-specific one-on-one interaction supports reduced defaults.\textsuperscript{35} This study also found that lower retention rates were significantly correlated with higher default rates for four-year institutions, but not two-year. This lack of significance is not encouraging for community colleges and two-year for-profit institutions as it implies that gaining a two-year degree does not reduce likelihood of financial hardship leading to default. Though, some studies suggest that attending a for-profit institution for an associates’ degree raises the likelihood of completion by as much as nine percentage points, this would unlikely help in reducing default rates for large portions of their student body.\textsuperscript{36}

Although default rates for for-profits are comparable to community colleges, the accompanying size of the loans are not. The average federal loan held by a community college student is only $4,093, about 35\% less than the average loan held by a for-profit student in a two-year program.\textsuperscript{37} Furthermore, approximately 85.6\% of students in community college owe no student loans, compared to only 3.3\% in two-year for-profit programs.\textsuperscript{38} From statistics provided in the Consumer Financial Protection Bureau’s \textit{Private Loans} report, it is possible to estimate the approximate amount of default of federal loans expected for one-hundred students entering a program by school-type (Chart 4; see Appendix IV for calculations).

Taking one year of costs into consideration, the expected dollar amount of default of the top ten largest for profit institutions is more than ten times larger than community colleges and more than twice that of public institutions. When considering the length of programs and the

\textsuperscript{35} Dillon & Smiles. \textit{Lowering Student Loan Default}. (2011) 19-23
\textsuperscript{37} CFPB. \textit{Private Student Loans}. (2012) 49
\textsuperscript{38} 
\textit{Ibid}. 47
total amount of debt accumulated, the proportions may change somewhat.\textsuperscript{39} However, this graph clearly illustrates the burden created when tuitions drive up the borrowing of student loans for populations with high risks of default.

\begin{center}
\includegraphics[width=\textwidth]{chart.png}
\end{center}

The effect of the growth of just a few institutions has important implications regarding targeting efforts to lower default rates. The largest of these schools have large recruitment efforts and tuition support, spending around 25\% on revenue on admissions and marketing efforts, suggesting that the target population responds positively to proactive guidance.\textsuperscript{40} Alice Graulty, Cash for College Coordinator at Foundations Communities in Austin, TX noted that many of her clients who need to clear up past for-profit student loan debt do not realize that they even have outstanding debt because the school had taken care of the loan process.\textsuperscript{41} Businesswise, this helps remove the “hassle cost” of paperwork on enrollment decisions, which undecided and non-

\textsuperscript{39} However, higher debt due to more time in school does not appear to have a linear relationship with default, perhaps due to the “persistence” of students that stay in school longer (Herr & Burt, \textit{Predicting} (2005), 43), suggesting that these proportions may remain even after weighted by years in school.

\textsuperscript{40} Ibid.8. For example. The Apollo Group, parent company of University of Phoenix, spent approximately 25\% of its $4.2B in revenue on marketing and admissions advisory. (Apollo Group, \textit{Annual Report} (2012), 53).

\textsuperscript{41} Graulty, Alice, Phone Interview. (March 28, 2013)
traditional students may experience more intensely.\textsuperscript{42} Thus, efforts to reduce default rates for this large portion of students entering repayment should include engagement at the point of loan, and be as simple and proactive as possible.

From a partnership-development perspective, there appears to be several opportunities for working with for-profits on financial education and default reduction efforts. The advantages of working with the largest for-profits include access to students at the point of making a loan and well-funded administrative personnel support and marketing. While research only loosely supports the effectiveness of counseling in reducing student loan default rates, research from the nonprofits working with high risk populations in homeownership indicates that counseling helps in guiding borrowers to smarter repayment options, but not in reducing default propensities.\textsuperscript{43} Jacki White, Loan Fund Manager at NeighborWorks of Western Vermont, echoed this sentiment, “When we are intense in emphasizing what will happen [if they do not repay], the better the behavior… when people do not know what to do, they try to ignore the problem hoping it will go away, but it doesn’t.”\textsuperscript{44} Thus, there could be a major education opportunity to promote the IBR programs early on if it is framed as a strategy to enroll borrowers in a “smarter” plan and emphasizes the serious consequences for avoiding student loans once in repayment. With enrollment numbers down, there may be some reluctance to discuss the seriousness of loan repayment options for fear of scaring away customers in their target market. Nonetheless, the corporate for-profits will need to strategize ways to reduce negative publicity due to high default rates, and IBR programs may provide a particularly convenient way to do so.

However, the larger issues of increasing student debt without correlating educational outcomes have broader public value implications, which an overly successful IBR effort might

\textsuperscript{42} Orfield. “Money Equity” (1992) 95
\textsuperscript{43} Quercia & Spader. “Homeownership Counseling” (2008) 304
\textsuperscript{44} White, Jacki, In-person interview. (April 5, 2013)
hide. It seems reasonable incorporate size, cost, and percentage of students borrowing into federal loan eligibility calculations, in order to promote less expensive use of taxpayer resources for underwriting access to education. Recently proposed gainful employment rules attempted to change regulations in that spirit, although a federal judge vacated them in March 2013.45 Another, strategy would be to increase Pell Grant access and lower loan limits for the first year of school to decrease initial student debt and allow folks to “try out” higher education with less upfront risk.46 A cost benefit analysis would be necessary to assess the budgetary and social impacts of this strategy.

**Incentives of Student Loan Servicers**

Over the past several years, student loan servicers have seen tremendous changes in their revenue generation due to the major shifts in the structure of federal student loans. From 1965 to 2010, many servicers of federal loans also lent federally guaranteed loans through the FFELP. This created a system where banks and lenders could grant loans to students with a guarantee from the federal government that they would be largely repaid. From 2000 to 2010, 72% of loans guaranteed by the federal government were originated through this structure, equivalent to approximately $426.2 billion before interest accrual.47

The program was designed to incentivize banks to lend to students at or below a maximum interest rate of 7.9%, a relatively low rate for lending to those with no credit history.48 However, servicers could also be collectors of defaulted loans, and so revenue generation could

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45 Bidwell, “Judge Refuses to Restore Vacated Provisions of ‘Gainful Employment’ Rule” (2013). These Gainful Employment rules stated that for-profits must meet at least one of three benchmarks that indicate either a third of graduates are repaying their loans or median debt is not above a third of graduates’ income.
48 Kantrowitz. “Direct Loans vs. FFEL”
include servicing fees, maximizing interest payments by allowing for the maximum amount of forbearance, and additional collection fees up to 16.2% of the outstanding loan once a borrower enters default.\textsuperscript{49} In an episode of 60 Minutes in 2006, then Harvard professor and bankruptcy expert Elizabeth Warren warned that the current structure allowed for lenders to “play every hand at the poker table.”\textsuperscript{50}

From the perspective of the cost to the government, supporting the FFELP system cost twice as much as direct loans; the subsidy structure reimbursed collection agencies for successful collection efforts on defaulted loans and for defaulted loans with low repayment prospects.\textsuperscript{51} When the Obama Administration ended the program in 2010, the Congressional Budget Office estimated $68.7 billion in savings for the federal government over 10 years.\textsuperscript{52}

For servicers like Sallie Mae and PHEAA, this resulted in significant losses on their balance sheets. In addition to cash flows related directly to the loan, portfolios of loans could be repackaged and sold to investors as low-risk student loan asset backed securities (SLABS) and provide a second source for revenue through the financial markets.\textsuperscript{53} Although the program ended two years ago and the related assets will amortize over the next twenty years, FFELP related services currently generate 72% of student loan related revenue for Sallie Mae.\textsuperscript{54}

Since 2010, the Department of Education has been the sole originator of Direct Student Loans. The servicing for the repayment of these loans is contracted out to a combination of four major servicers--Sallie Mae, PHEAA, Nelnet, and Great Lakes—and thirteen smaller servicers. Nelnet and Sallie Mae are for-profit public companies, while the rest are non-profits, many of

\textsuperscript{49} New York State Higher Education Services Corporation.
\textsuperscript{50} Jaschick. “60 Minutes’ vs. Sallie Mae.” (2006)
\textsuperscript{51} Lucas & Moore, “Guaranteed versus Direct Lending: The Case of Student Loans.” (2010) 17
\textsuperscript{52} New America Foundation. “Guaranteed versus Direct” (2010) 176
\textsuperscript{53} Lucas & Moore, “Guaranteed versus Direct” (2010) 176
\textsuperscript{54} Sallie Mae. \textit{10-K} (2012) 8
which also service state grants and financial aid. The new contracts created by the ED pay these servicers on a per-unit basis based upon the composition of borrowers in repayment; servicers receive $2.11 per month for students in good standing and only $0.50 for students in default (see Appendix VI for Price Table). Annual allocations of student loans are based upon a formula that includes default status per unit, total defaulted dollars outstanding, and survey ratings by borrowers, schools, and the U.S. Office of Student Aid (Appendix VII).

When considering the scope of the contract only, it appears that student loan servicers have every incentive to keep students in good standing for repayment since future market shares of the Direct Loan business units rely winning contracts based upon good default aversion outcomes and customer service. However, this contract with the Federal Government accounts for only 1.3% of Sallie Mae’s annual revenues—generating $84 million compared to $2.7 billion in FFELP and $2.5 billion in consumer servicing revenues. From a business perspective, the new structure does not provide much of a growth market compared to other consumer lending activities. Accordingly, Sallie Mae’s primary strategies for delivering shareholder value do not include federal direct loans. Instead, management is focusing on growing consumer-lending segment assets and revenues, reducing operating expenses, and maximizing cash flows from FFELP Loans. The lack of attention towards Direct Loans from the country’s largest servicer shows. In the 2012 ED Allocation Metric, it ranked last in overall performance (Appendix VII).

From the outside, it is difficult to assess the level of any of the company’s commitments to meeting the spirit of the new contract structure. The company that scored highest in customer service was PHEAA, a non-profit organization with $497.4 million in 2012 operating revenues

55 Ibid. 9 & 41
56 Ibid. 52
that uses profits from its operations to generate grant aid in Pennsylvania.\(^{57}\) It appears to be taking on federal student loan servicing with gusto, creating a separate website called “Myfedloans.org” and aggressively seeking out and winning special contracts, such as the Public Service Loan Forgiveness Program. Furthermore a “snapshot” customer service survey of the four major servicers revealed little meaningful variation in the content of answers and friendliness of customer service representatives (see Appendix VIII).\(^{58}\)

Still, it is possible to consider current market incentives and consider their likely impact on repayment counseling and internal policies. Under the current system, counseling is highly customized to the borrower’s situation and the nature of the advice appears to lean towards encouragement of early repayment and the promotion of the new Public Service Loan Forgiveness Program.\(^{59}\) Servicers were quite open to talking about the usefulness of IBR in helping folks get through economic hardship.

Although actual overhead costs related to Direct Loan servicing are not published, servicers presumably have several overhead costs that currently make IBR more costly than the standard program due to the annual paperwork requirements for income verification. In theory, the value of getting students at risk of default into IBR would equal the loss that they would expect to undergo without the program. Assuming a 4% annual increase in the number of high risk borrowers entering repayment per year and three million borrowers entering repayment per year, the value of default-aversion activities could be as high as $2.3 million annually. However, isolating the high risk population is a challenge, especially considering that the average

\(^{57}\) PHEAA. *Annual Report.* (2012) 22

\(^{58}\) This assessment is biased by the fact that all contact with servicers was proactive and prior to the actual repayment period, which means that these observed tendencies should not indicate the absolute reality of servicers’ counseling behavior, but instructive nonetheless.

\(^{59}\) Based upon various conversations with representatives of Sallie Mae and MyFedLoan.org. Also, reflected in the customer service snapshot
American is now more vulnerable to unexpected financial emergencies than in the recent past. Some targeting efforts under the status quo could include flagging students that dropped out of their programs or developing outreach efforts to those who also received Pell Grants—which correlate well with pre-loan predictors of default.⁶⁰

Despite additional annual paperwork, making the IBR program the automatic option would have several benefits for servicers. Currently there are so many repayment options that counselors need significant training to help students find the best options given their situation, which can include heavy training and personnel costs. Simplified choices would likely reduce these.⁶¹ It would also provide the output of higher IBR enrollment, likely reducing defaults and increase access to higher fees under the servicing contract.

On the practical side of implementation, determining the income necessary to calculate the repayment amount, especially on the first bill, could prove to be a significant challenge, and presents certain tradeoffs. If the initial bill is too small, the borrower who is new to repayment may underestimate the cost of paying too little in the beginning of repayment, creating a situation where the borrower ultimately pays more for their student loan.⁶² However, a bill that is too large might create panic and lead to unproductive avoidance behavior. Considering that payments generally begins six months after entering repayment, the borrower who completed a spring semester would only have four months to get into trouble before tax season creates a natural opportunity to reassess the minimum repayment amount. For those who drop out or graduate in December, however, the window would be large enough for an individual to reach default status.

Early and intense messaging about first the availability of help, second the accrued interest that

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⁶⁰Dillon & Smiles. *Lowering Student Loan Default.* (2011) 19-23
⁶¹ Based upon April 17, 2013 phone conversation with a public relations manager at MyFedLoan.org. He also noted that the company maintains an agnostic public position related to federal repayment initiatives and policies.
⁶² Including an estimate for total payments considering minimum repayment, might be enough incentive to promote higher repayment, although it would need to be tested.
might build with minimum payments, and finally the consequences for avoiding repayment could nudge borrowers to in fixing account problem early. Even though automatic enrollment in IBR would likely still have flaws, these problems could even help encourage borrower engagement early in the process. A combination of automatic enrollment in IBR and careful messaging contrasts with the current standard structure which appears to rely more heavily on proactive borrower inquiry.

The benefits to the servicer of transferring old FFELP loans into an IBR, whether on a case-by-case basis or through an automatic program, is less clear. As mentioned, servicers generate revenue under the FFELP program through collecting interest, servicing fees, collection fees, and income related to the conversion of student loan portfolios into SLABS and selling them to traders in the financial market. The changes in the 2008 legislation altered this formula, allowing FFELP loans to be covered by IBR, whether consolidated with Direct Loans or not, and opening a door to loan forgiveness.

Considering this and the loss of access to new guaranteed loans, a great deal of emphasis has shifted to packaging private loans and presumably old FFELP loans into securities for investors. Although the asset backed securities market largely lost salience during the financial crisis, SLABS appear to be regaining some momentum as higher risk, but higher yield investments. As recently as March, Sallie Mae sold $1.1 billion worth of new student loan securities to Wall Street.63 Although the portfolio of assets used to create these securities likely consists of private loans, the critical point is that securitization invites investors to influence the servicers’ corporate logic. Should actively traded SLABS include FFELP loans, servicers would have additional contractual obligations to the shareholders about the handling of the accounts.

This could create incentives that do not benefit the student loan borrower, and may skew internal policies for servicing old loans. Thus, the calculus of “maximizing cash flows from the FFELP program” may include supportive counseling in order to improve the stability of the security. However, it could also include allowing delinquency and default to work in the servicer’s favor in the form of fees and ballooning principal. Considering the forgiveness aspect of the IBR program, it doesn’t seem logical for servicers to proactively promote this program to borrowers with FFELP loans, as it could result in an eventual loss for the investors.

**Discussion of IBR Implementation Options**

IBR is an example of a policy that should have a resounding effect in reducing default rates as it provides a generous and flexible answer to an individual’s financial hardships. From diving into the literature and recent news of the program, it appears that it still may be too early to assess the programs potential effectiveness, given the time necessary to fundamentally change the loan origination and repayment structures. Furthermore, only three cohorts of students entering repayment under the new structure have been measured, further underscoring the limitations for assessing success. After all, cohort default rates did not drop for two years after the 1990 Omnibus Budget Reconciliation Act, assuming that the decrease was not confounded by other factors from the time (see Chart 1 for reference).

In determining whether to make IBR programs the automatic option, certain probable limits should be recognized. First, the program would not solve some underlying issues with the highest risk population. In my interview with Foundation Communities’ Cash for College Coordinator, Graulty pointed out that many who come to speak with her know that they have debt, but have trouble keeping track of it because they have moved several times and do not have
easy access to a computer. More proactive default reduction outreach efforts would likely be necessary to effectively meet the needs of this population. Furthermore, there may be alternative reasons why people go into default that go beyond ability to pay. For instance, in a survey of a small sample of defaulted borrowers seeking legal aid, 47% said that they should not have to repay. The two primary reasons included uselessness of the degree and frustration about having already paid multiples of the principle. However, the actual size of this population is unknown, and these sentiments may be partially avoided if repayment amounts better match ability to pay.

Furthermore, although the program might add value in financial leniency, making it the automatic option would add some burden of paperwork to the borrower due to the need to provide annual proof of income. Currently, the IBR online qualification system is connected with the Internal Revenue Service’s system, making it fairly simple to prove income requirements. However, the system is very particular about inputs and will not work if there is variation from last year’s tax return. For example an error will occur if you input “apt” instead of “apartment” in the address field. Some customers may not appreciate yearly interaction with servicers in order to prove income. However, if the program is linked with tax preparation, the burden of an extra interaction could be largely reduced. Considering that the official threshold for “default status” is 270 days delinquent, this leaves a window of only 96 days where a person could go into full default without having their income incorporated into the repayment formula.

More targeted populations could be selected to be automatically enrolled in IBR, which could be combined with upfront counseling initiatives or requirements based upon at risk populations. For instance, targeting students who have also received Pell Grants for increased loan counseling and automatic enrollment in the income-based repayment program could

64 Graulty. Phone Interview (March 28, 2013)
65 Loonin, Deanne. Default Trap. (2012) 19
66 Graulty, Phone Interview (March 28, 2013)
improve the programs impact without the negative implications that might accompany other targeting methods. Students who drop out of their programs could also be flagged. However, by targeting specific populations, the loan servicers would likely gain fewer cost reductions related to the level of expertise necessary to effectively guide students to the best available program, which may reduce buy-in from this important stakeholder.

Whether the status quo is maintained or IBR as an automatic option is extended to all new cohorts entering repayment, the population’s old loans under the FFELP program present a unique challenge. Since the last FFELP loan was issued as recently as 2010, borrowers will continue to be repaying under this framework for many more years, and the incentive suggests that servicers may not proactively recommend IBR to this population. However, mandating that servicers transfer all old FFELP loans into an IBR plan may not be an appropriate solution either. There are 37 million people currently in repayment and 7 million who have entered repayment since the end of the FFELP program. Since 72% of loans under the old structure were through FFELP, we can conservatively estimate that 70% of the loans held by 30 million Americans are still in this program.⁶⁷ Requiring that all of these people report their income in order to calculate the IBR payment would be a complicated and costly undertaking, and would likely confuse people who are currently in good standing with their loans. Thus, a more feasible option for the federal government might be to offer targeted educational and incentive programs so that those who would benefit from the program might self-select. Analyzing the FFELP and Direct Loan consolidation initiative in 2011 might provide some insights as to the best approach. A second option would be to pay special attention to the defaulting behavior on older loans and to provide some incentives (or rules) to servicers for proactively transferring delinquent borrowers to flexible payment plans.

**Recommendation**

Even considering these caveats, the generosity and flexibility that IBR offers seems to meet the needs of many who are unnecessarily suffering from high student loan payments. In order to explore the best way to improve the impact of the program, I recommend developing two pilot programs. First, since much of the rise in the default rate can be traced to just ten for-profit institutions and those same institutions are suffering from the negative publicity related to increased default rates, there is a unique opportunity to make a large impact by developing a few key partnerships with for-profit institutions. A pilot program could test various counseling techniques to promote education about the current flexibilities of the current financial aid structure, as well as serious consequences associated with avoiding repayment, especially prior to the disbursement of the loan. Such an initiative would target the right population, leverage well-funded admission resources that already exist in these schools, and likely help these for-profits in reducing the risks and poor publicity associated with high default rates.

Second, ED should partner with servicers to test making IBR programs the automatic option for borrowers entering repayment, especially testing whether it (1) negatively impacts default rates and (2) systematically impacts some groups more than others. This would improve understanding of the effectiveness of IBR and help inform future policy decisions. Participating servicers would also benefit from increased revenue due to the higher per unit fees related to effective default prevention and better internal understanding default reduction techniques that may result in a competitive advantage for future contracts.

Following these recommendations would allow for data-driven implementation improvements within the federal student loan system. More broadly, efforts to reduce the financial risk of higher education debt supports the ambition that Americans, no matter their
situation, can strive to better their own lives. Higher education is increasingly a prerequisite for individuals to join the middle class and for nations to maintain their global competitiveness. However, rising costs of education and tighter markets also increases its financial riskiness to the individual. Thus, meeting the financial needs of those who try to obtain a degree is a key aspect in achieving the President’s goal to be the most educated country in the world.
## Appendix I – Student Loan Comparisons

<table>
<thead>
<tr>
<th></th>
<th>Standard</th>
<th>Income-Contingent</th>
<th>Income-Based</th>
<th>Pay as You Earn</th>
<th>Public Service Loan Forgivenes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Implementation</strong></td>
<td><em>None</em></td>
<td><em>Not added to repayment on drop-down menu until March 2010</em></td>
<td><em>None reported</em></td>
<td></td>
<td><em>Tracking form became available January 2012</em></td>
</tr>
<tr>
<td><strong>Notes</strong></td>
<td><em>in 2009 government began originating all federally guaranteed loans</em></td>
<td><em>Do not qualify for &quot;Pay as You Earn&quot;</em></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Restricted to</strong></td>
<td>NA</td>
<td><em>None</em></td>
<td><em>Partial Financial Hardship Standard payment/mo &gt; Income Based program</em></td>
<td><em>Pay as You Earn program</em></td>
<td><em>Borrowers working in public service</em></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>Partial Financial Hardship Standard payment/mo &gt; Pay as You Earn program</em></td>
<td></td>
<td><em>Repayments made after October 1, 2007</em></td>
</tr>
<tr>
<td><strong>Loans that Qualify</strong></td>
<td><em>All direct loans, FFEL loans</em></td>
<td><em>Federal Direct loans</em></td>
<td><em>Federal Direct loans</em></td>
<td><em>Federal Direct loans</em></td>
<td><em>Federal Direct (all, including Parent PLUS) Consolidated FFEL loans</em></td>
</tr>
<tr>
<td></td>
<td><em>Private loans</em></td>
<td><em>FFEL Loans (must consolidate)</em></td>
<td><em>FFEL Loans (must consolidate)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loans that Don't Qualify</strong></td>
<td><em>Extended and graduated payments</em></td>
<td><em>FFEL loans Private loans</em></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Minimum Payment</strong></td>
<td>$50</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Payment Formula</strong></td>
<td><em>Based on total loans and 10 years to repay</em></td>
<td><em>Adjusted gross family income and family size</em></td>
<td><em>15% of adjusted gross family income (income - 150% of poverty line) and family size</em></td>
<td><em>10% of adjusted gross family income (income - 150% of poverty line) and family size</em></td>
<td><em>Pay as you earn, IBR, ICR, standard, any plan equivalent to standard</em></td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>Complex formula based upon adjusted gross family income and family size</em></td>
<td><em>Recalculated annually</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Discharge</strong></td>
<td>NA</td>
<td><em>25 years</em></td>
<td><em>25 years</em></td>
<td><em>20 years</em></td>
<td><em>10 years</em></td>
</tr>
<tr>
<td><strong>Notes</strong></td>
<td><em>According to a discussion with a Sallie Mae representative about my FFELP loans - if your account is &gt;90 days due, you are in “default” and there will be a late fee. However, they can put your account into forbearance retroactively to put you back in good standing and get you into a program. Also, you can make payments to rehabilitate your loan, and then qualify for the program. (4/11/13)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Sources**
Appendix II – For-Profits Recoded to “Ten Largest For-Profits”

<table>
<thead>
<tr>
<th>NAME</th>
<th>State</th>
<th>Program Length</th>
<th>Defaulted Borrowers</th>
<th>Entered Repayment</th>
<th>Default Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>University of Phoenix</td>
<td>Arizona</td>
<td>Master’s or Doctor’s</td>
<td>41,148</td>
<td>229,393</td>
<td>18%</td>
</tr>
<tr>
<td>ITT Technical Institute</td>
<td>Indiana</td>
<td>Master’s or Doctor’s</td>
<td>7,127</td>
<td>42,959</td>
<td>17%</td>
</tr>
<tr>
<td>Kaplan University</td>
<td>Iowa</td>
<td>Master’s or Doctor’s</td>
<td>7,053</td>
<td>41,819</td>
<td>17%</td>
</tr>
<tr>
<td>DeVry University</td>
<td>Illinois</td>
<td>Master’s or Doctor’s</td>
<td>4,361</td>
<td>32,588</td>
<td>13%</td>
</tr>
<tr>
<td>Ashford University</td>
<td>Iowa</td>
<td>Master’s or Doctor’s</td>
<td>2,494</td>
<td>24,319</td>
<td>10%</td>
</tr>
<tr>
<td>Strayer University</td>
<td>District of Columbia</td>
<td>Master’s or Doctor’s</td>
<td>1,912</td>
<td>22,219</td>
<td>9%</td>
</tr>
<tr>
<td>Colorado Technical University</td>
<td>Colorado</td>
<td>Master’s or Doctor’s</td>
<td>2,399</td>
<td>18,065</td>
<td>13%</td>
</tr>
<tr>
<td>American InterContinental University</td>
<td>Illinois</td>
<td>Master’s or Doctor’s</td>
<td>2,497</td>
<td>17,598</td>
<td>14%</td>
</tr>
<tr>
<td>Grand Canyon University</td>
<td>Arizona</td>
<td>Master’s or Doctor’s</td>
<td>1,994</td>
<td>16,490</td>
<td>12%</td>
</tr>
<tr>
<td>Walden University</td>
<td>Minnesota</td>
<td>Master’s or Doctor’s</td>
<td>368</td>
<td>12,882</td>
<td>3%</td>
</tr>
</tbody>
</table>


Appendix III – Comparison of Outcomes Between Plans with Net Present Values

<table>
<thead>
<tr>
<th>Payment Plan</th>
<th>Years to Repay</th>
<th>Monthly Payment</th>
<th>Nominal Payment</th>
<th>Total Nominal Payment Less Principle</th>
<th>Nominal Balance Sheet Forgiveness</th>
<th>NPV Payment</th>
<th>NPV of Total Payment Less Principle</th>
<th>NPV Balance Sheet Forgiveness</th>
<th>NPV of Total Payment2</th>
<th>NPV Balance Sheet Forgiveness2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>10</td>
<td>$345</td>
<td>$43,470</td>
<td>$13,470</td>
<td>$34,728</td>
<td>$800</td>
<td>$29,110</td>
<td>$800</td>
<td>$14,121</td>
<td>$14,121</td>
</tr>
<tr>
<td>IBR</td>
<td>20</td>
<td>$106</td>
<td>$27,348</td>
<td>(2,652)</td>
<td>$54,887</td>
<td>$19,719</td>
<td>$15,552</td>
<td>$25,100</td>
<td>$17,598</td>
<td>$17,598</td>
</tr>
<tr>
<td>IBR Income in Yr 5</td>
<td>20</td>
<td>$106</td>
<td>$27,348</td>
<td>(2,652)</td>
<td>$54,887</td>
<td>$19,719</td>
<td>$15,552</td>
<td>$25,100</td>
<td>$17,598</td>
<td>$17,598</td>
</tr>
</tbody>
</table>

Note: Based upon unmarried student with no dependents, stagnant income, and $30,000 in debt at 6.8% interest rate. Calculated using MyFedLoan.org’s Repayment Schedule Estimator, under the “Pay as You Earn” Program.

Appendix IV – Calculations for Drivers of the Change in Default Rates, 2000-2010

PP = Percentage Point Change in Default by School-Type
D = Number of defaulters by School-Type
TR = Total Number Entering Repayment
TC = Total Change in Default Rate

PP = (D10 / TR100) – (D00 / TR00)

Drivers of Change in Default Rate = PP/TC

<table>
<thead>
<tr>
<th>School Type</th>
<th># Institutions</th>
<th># Repayers</th>
<th>Defaulters/Total Repayers</th>
<th># Institutions</th>
<th># Repayers</th>
<th>Defaulters/Total Repayers</th>
<th>Percentage Point Change in Default</th>
<th>Driver of Default Rate Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ten Largest For-Profits</td>
<td>9</td>
<td>53,429</td>
<td>3,533 0.1%</td>
<td>10</td>
<td>458,332</td>
<td>71,353 1.7%</td>
<td>1.5%</td>
<td>41.0%</td>
</tr>
<tr>
<td>For-Profit Schools</td>
<td>1,809</td>
<td>317,925</td>
<td>28,262 1.2%</td>
<td>1,866</td>
<td>816,316</td>
<td>93,924 2.2%</td>
<td>1.0%</td>
<td>27.3%</td>
</tr>
<tr>
<td>&quot;Community College&quot;</td>
<td>1,356</td>
<td>307,252</td>
<td>26,583 1.1%</td>
<td>1,169</td>
<td>629,356</td>
<td>83,739 2.0%</td>
<td>0.9%</td>
<td>22.8%</td>
</tr>
<tr>
<td>Public School, 4+ Years</td>
<td>583</td>
<td>1,015,307</td>
<td>44,706 1.9%</td>
<td>634</td>
<td>1,404,957</td>
<td>87,431 2.1%</td>
<td>0.2%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Nonprofit Private Schools</td>
<td>1,756</td>
<td>665,007</td>
<td>23,222 1.0%</td>
<td>1,633</td>
<td>910,462</td>
<td>48,151 1.1%</td>
<td>0.2%</td>
<td>4.2%</td>
</tr>
<tr>
<td>Total</td>
<td>5,513</td>
<td>2,359,820</td>
<td>126,316 5.4%</td>
<td>5,312</td>
<td>4,219,423</td>
<td>384,598 9.1%</td>
<td>1.8%</td>
<td></td>
</tr>
</tbody>
</table>

### Calculation of Expected Dollars in Default

<table>
<thead>
<tr>
<th>School Type</th>
<th>Federal Loans (when mixed with private)</th>
<th>Non-Private Loans Only</th>
<th>Federal Loans (when mixed with private)</th>
<th>Non-Private Loans Only</th>
<th>Federal $ per 100 entering repayment</th>
<th>Default Rates</th>
<th>Expected Default</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Largest For-Pros</td>
<td>5,923</td>
<td>6,477</td>
<td>44.7</td>
<td>49</td>
<td>582131.1</td>
<td>16%</td>
<td>$90,230</td>
</tr>
<tr>
<td>Private for-Prof</td>
<td>5,923</td>
<td>6,477</td>
<td>44.7</td>
<td>49</td>
<td>582131.1</td>
<td>12%</td>
<td>$66,945</td>
</tr>
<tr>
<td>Private Not-for-Prof</td>
<td>6,641</td>
<td>8,160</td>
<td>20.6</td>
<td>34.9</td>
<td>421588.6</td>
<td>5%</td>
<td>$22,344</td>
</tr>
<tr>
<td>Public 4-Year</td>
<td>5,595</td>
<td>6,706</td>
<td>9.6</td>
<td>33</td>
<td>275010</td>
<td>6%</td>
<td>$17,051</td>
</tr>
<tr>
<td>Community Colleges</td>
<td>3,831</td>
<td>4,093</td>
<td>1.9</td>
<td>9.6</td>
<td>46571.7</td>
<td>13%</td>
<td>$6,194</td>
</tr>
</tbody>
</table>

Source: CFPB. *Private Student Loans.* (2012)
Appendix VI

Current ED Contract with Student Loan Servicers

<table>
<thead>
<tr>
<th>Status</th>
<th>Volume Low</th>
<th>Volume High</th>
<th>Unit Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowers in School Status</td>
<td>na</td>
<td>na</td>
<td>$ 1.05</td>
</tr>
<tr>
<td>Borrowers in Grace or Current Repayment Status</td>
<td>1</td>
<td>3,000,001 UP</td>
<td>$ 2.11</td>
</tr>
<tr>
<td>Borrowers in Deferment or Forbearance</td>
<td>1</td>
<td>1,600,001 UP</td>
<td>$ 2.07</td>
</tr>
<tr>
<td>Borrowers 31-90 Days Delinquent</td>
<td>na</td>
<td>na</td>
<td>$ 1.62</td>
</tr>
<tr>
<td>Borrowers 91-150 Days Delinquent</td>
<td>na</td>
<td>na</td>
<td>$ 1.50</td>
</tr>
<tr>
<td>Borrowers 151-270 Days Delinquent</td>
<td>na</td>
<td>na</td>
<td>$ 1.37</td>
</tr>
<tr>
<td>Borrowers 270+ Days Delinquent</td>
<td>na</td>
<td>na</td>
<td>$ 0.50</td>
</tr>
</tbody>
</table>

Source: Title IV Student Loan Management/Servicing. Sallie Mae Redacted Contract Award (June 6, 2013)
https://www.fbo.gov/index?s=opportunity&mode=form&id=c845bdd7d98de24fe163b8a55e5f76a8&tab=core&_cview=1

Appendix VII

Final Calculation for Fourth Year’s Allocation
FedLoan Servicing (PHEAA), Great Lakes, Nelnet, and Sallie Mae

Attachment to August 2012 Electronic Announcement

ONGOING ALLOCATION METRIC CALCULATION

<table>
<thead>
<tr>
<th>METRIC</th>
<th>FedLoan Servicing (PHEAA)</th>
<th>Great Lakes</th>
<th>Nelnet</th>
<th>Sallie Mae</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.29%</td>
<td>1.43%</td>
<td>0.68%</td>
<td>1.26%</td>
</tr>
<tr>
<td>2</td>
<td>0.77%</td>
<td>0.85%</td>
<td>0.56%</td>
<td>0.77%</td>
</tr>
<tr>
<td>3</td>
<td>75.25</td>
<td>75.42</td>
<td>73.92</td>
<td>72.75</td>
</tr>
<tr>
<td>4</td>
<td>72.84</td>
<td>77.87</td>
<td>74.42</td>
<td>72.00</td>
</tr>
<tr>
<td>5</td>
<td>76.75</td>
<td>72.75</td>
<td>65.00</td>
<td>94.25</td>
</tr>
</tbody>
</table>

ALLOCATION EACH SERVICER WILL RECEIVE

<table>
<thead>
<tr>
<th>METRIC</th>
<th>Total Score</th>
<th>% of New Volume Servicer Will Receive (Total Score / Combined Totals)</th>
<th>New Borrowers (based on 3.6 M total new borrowers)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FedLoan Servicing (PHEAA)</td>
<td>13.59</td>
<td>27.00%</td>
<td>972,000</td>
</tr>
<tr>
<td>Great Lakes</td>
<td>14.00</td>
<td>28.00%</td>
<td>1,008,000</td>
</tr>
<tr>
<td>Nelnet</td>
<td>15.00</td>
<td>30.00%</td>
<td>1,008,000</td>
</tr>
<tr>
<td>Sallie Mae</td>
<td>7.50</td>
<td>15.00%</td>
<td>549,000</td>
</tr>
<tr>
<td>Combined Totals</td>
<td>50</td>
<td>100.00%</td>
<td>3,600,000</td>
</tr>
</tbody>
</table>
## Appendix VIII – Customer Service Survey Results

<table>
<thead>
<tr>
<th>Loan Service Provider (required)</th>
<th>If I am without work when my grace period ends, what would you recommend I do?</th>
<th>I'm particularly curious about the income based program. Under what conditions would you recommend that I enroll in the income based program? Why?</th>
<th>Are there problems with the income based repayment program?</th>
<th>Theoretically - What if I get a very well paying job after 18 years in the income based repayment program? Would I have to start the standard program again from year 0?</th>
<th>Rating of Customer Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>FedLoan Servicing</td>
<td>Defer</td>
<td>Economic Hardship</td>
<td>Must reapply each year</td>
<td>na</td>
<td>10</td>
</tr>
<tr>
<td>Sallie Mae</td>
<td>Defer</td>
<td>Qualification</td>
<td>Not qualifying</td>
<td>Reapply</td>
<td>5</td>
</tr>
<tr>
<td>Nelnet</td>
<td>IBR &amp; Defer</td>
<td>Economic Hardship</td>
<td>Interest accrual</td>
<td>Have to start paying at higher rate Do not lose 18 years of repayment history</td>
<td>9</td>
</tr>
<tr>
<td>Great Lakes</td>
<td>IBR &amp; Defer</td>
<td>Offered technical help to enroll</td>
<td>Interest accrual</td>
<td>No.</td>
<td>10</td>
</tr>
<tr>
<td>Great Lakes</td>
<td>Defer</td>
<td>Qualification</td>
<td>Interest accrual - although forgiven after 25 years</td>
<td>No.</td>
<td>10</td>
</tr>
<tr>
<td>FedLoan Servicing</td>
<td>Defer</td>
<td>Offered technical help to enroll</td>
<td>Longer process</td>
<td>No.</td>
<td>9</td>
</tr>
</tbody>
</table>
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