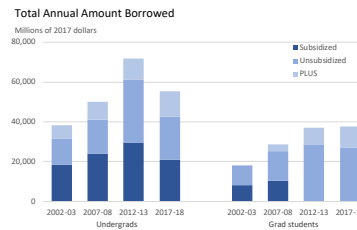




Improving Student Loan Outcomes through Better Policy



University of Massachusetts Boston Seminar

Karen Dynan
Harvard University
May 8, 2019

With thanks to Kayla Jones for research assistance

I worked on student loan policy while at Treasury as A/S for Economic Policy (2013-17)

Issues included the **College Scorecard**, **Gainful Employment** rule, **Income Driven Repayment**, and a “**risk-sharing**” proposal

Some at Treasury had access to **particularly useful data**—information about student loans from the Department of Education merged with IRS tax records

This talk will largely draw off **my own experience as well as work done by my former colleagues** (especially Adam Looney, Tara Watson, and Tiffany Chou)

Much concern then and now about student debt

OPINION | EDUCATION

The Financial Crisis Isn't Over for Students

As housing prices collapsed during and after the recession, student loan debt rose. And the government wants its money back.

By Noah Smith

64 March 27, 2018, 7:01 AM EDT Corrected March 28, 2018, 4:40 PM EDT



Hope they don't have too much in student debt. Photographer: Drew Angerer/Getty Images

Outline

Background on the federal student loan program

Items of particular concern:

Default rates understate borrower struggles

For-profits

High-balance borrowers

Large and growing racial disparities

Improving student loan policy

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Modern program established by Higher Education Act of 1965 (altered over time, typically with reauthorizations of the Act)

Covers 90 percent of new student borrowing

Stock of student debt outstanding at the end of 2018 was [\\$1.5 trillion](#)

New borrowing over the 2017-18 school year was \$94 billion—[61% of total federal higher-ed aid](#)

Interest rates set by Congress—interest rates on new loans currently between 5 and 8 percent depending on type of loan

KEY FEATURE: no underwriting in most cases—eligibility determined by enrollment at an accredited institution

Student loan limits

Limits on Federal **Direct Student Loans**

	Dependent Students	Independent Students
Undergraduate limits:		
First year	\$5,500	\$9,500
Second year	\$6,500	\$10,500
Third year	\$7,500	\$12,500
Fourth year	\$7,500	\$12,500
TOTAL	\$31,000	\$57,500
Graduate limits:		
Annual	\$20,500	
TOTAL (incl. undergrad loans)	\$138,500	

Source: [Department of Education](#) (2019)

Student loan limits

But **PLUS loans** for parents and graduate students do not have traditional limits

Here's a quick overview of Direct PLUS Loans:

- The U.S. Department of Education is your **lender**.
- You must not have an **adverse credit history**. A credit check will be conducted. If you have an adverse credit history, you may still be able to receive a PLUS loan if you meet additional requirements.
- The maximum PLUS loan amount you can receive is the cost of attendance (determined by the school) minus any other financial aid received.

Screenshot from [Department of Education](#)

Repayment

Standard repayment period is 10 years (high balance loans eligible for 25 years)

Repayment begins 6 months after graduation or separation

You are in default if payment is more than 270 days late

Hurts your credit score; interest continues to accumulate; puts you at risk of debt collectors coming after you, wage garnishment, or having your tax refund taken away and applied toward your debt

If you have difficulty making your payment

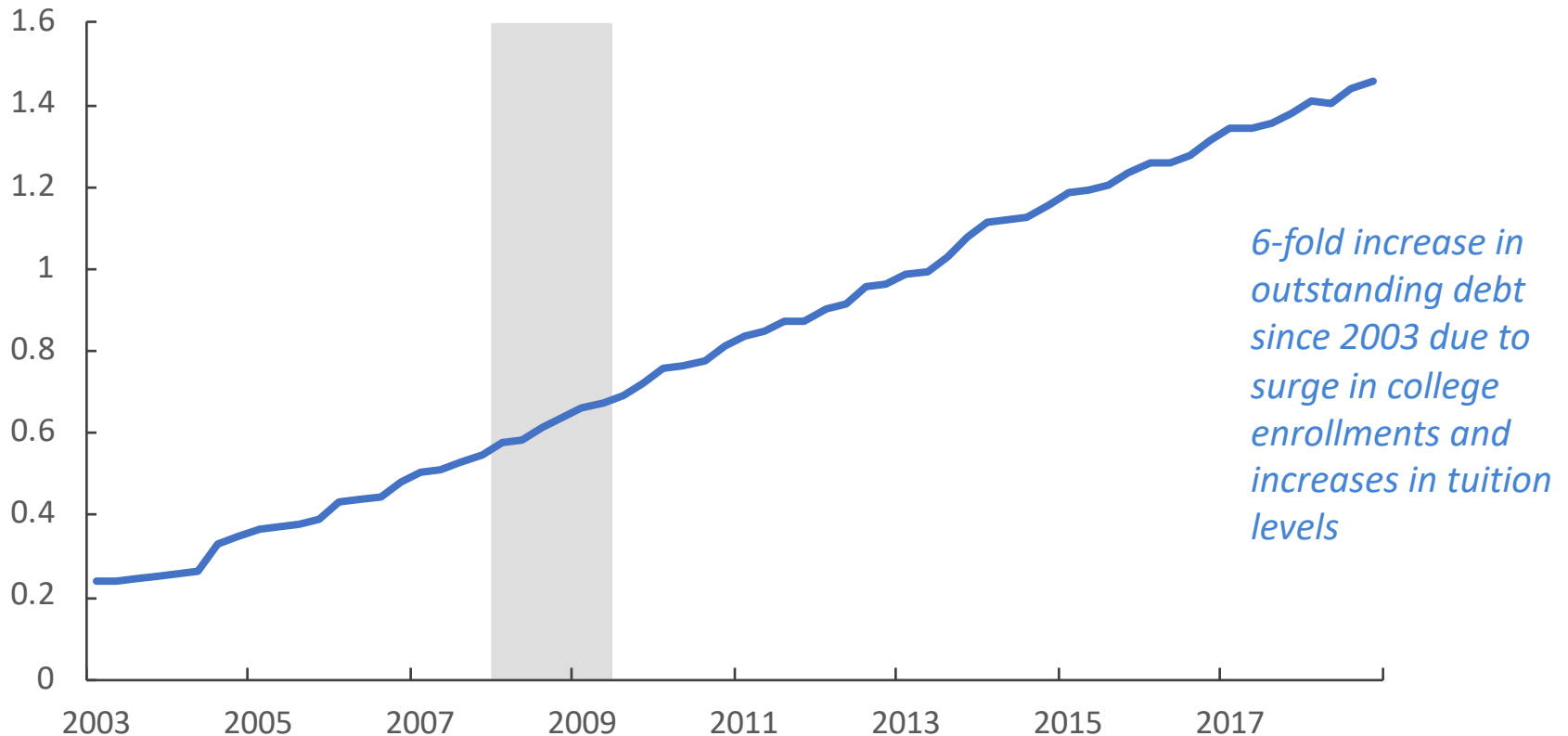
Your servicer may grant you **forbearance** or put you in **deferral**

You can enroll in an **income-driven-repayment (IDR) plan** that limits your monthly payment to a given fraction of your income—and forgives remaining balance after 20-25 years of reasonable payments

Much **more to come** on this topic

Outstanding student debt has grown rapidly

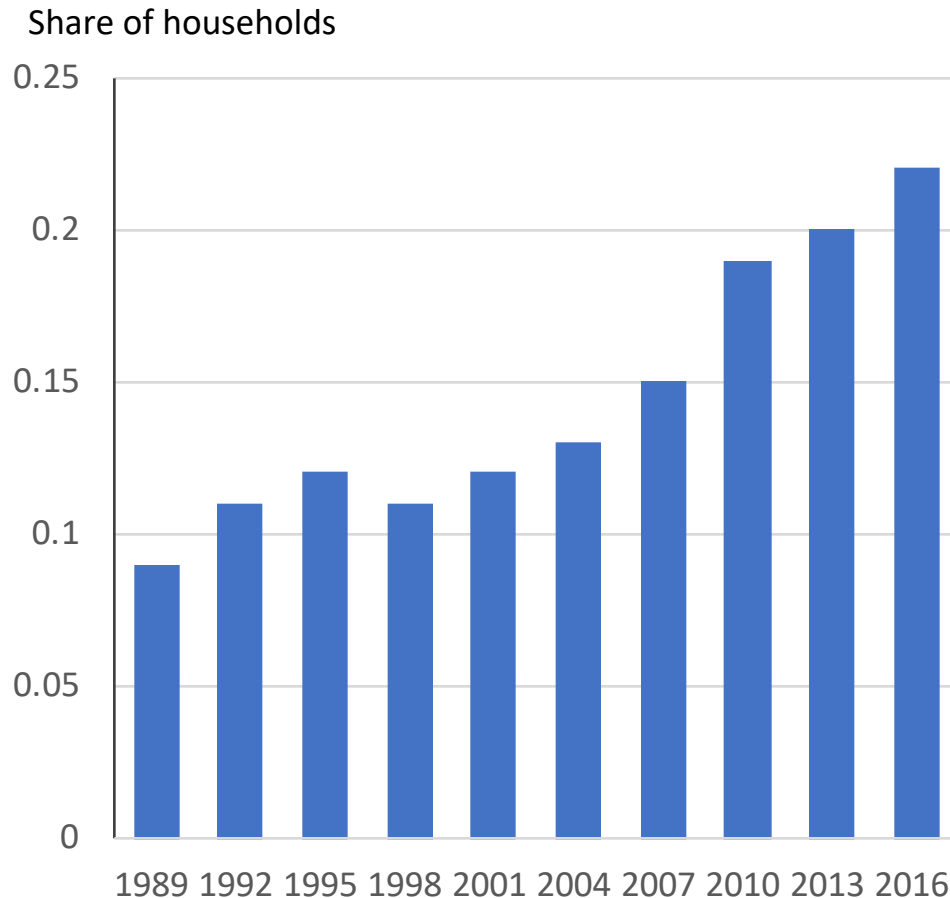
Trillions of dollars



Shaded area shows recession

Data from the [Federal Reserve Bank of New York](#)

More borrowers, more debt per borrower over time

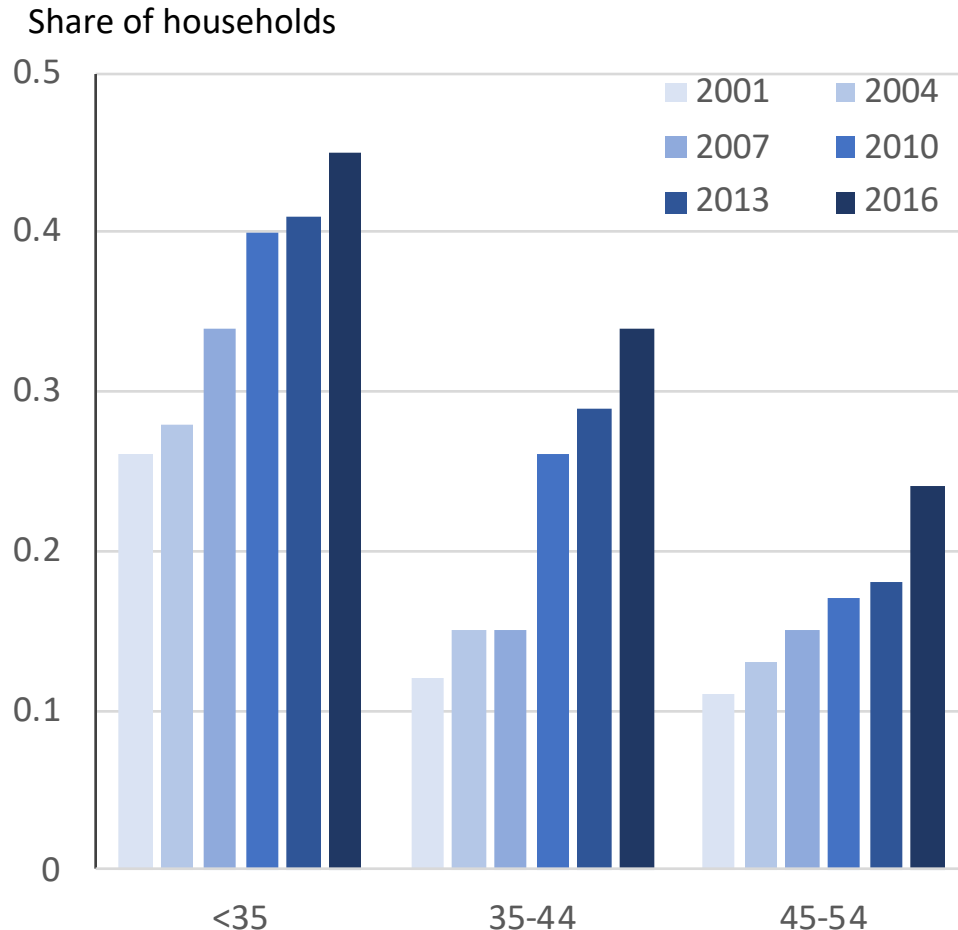


22% of households had some student debt in 2016, up from 9% in 1989

Median debt per borrowing household was **\$19,000 in 2016**, up from \$5,600 in 1989 (in 2016 dollars)

Data from [Survey of Consumer Finances](#)

The share of households with student debt has grown over time in all age groups



Nearly half of young households (heads less than 35) had student debt in 2016

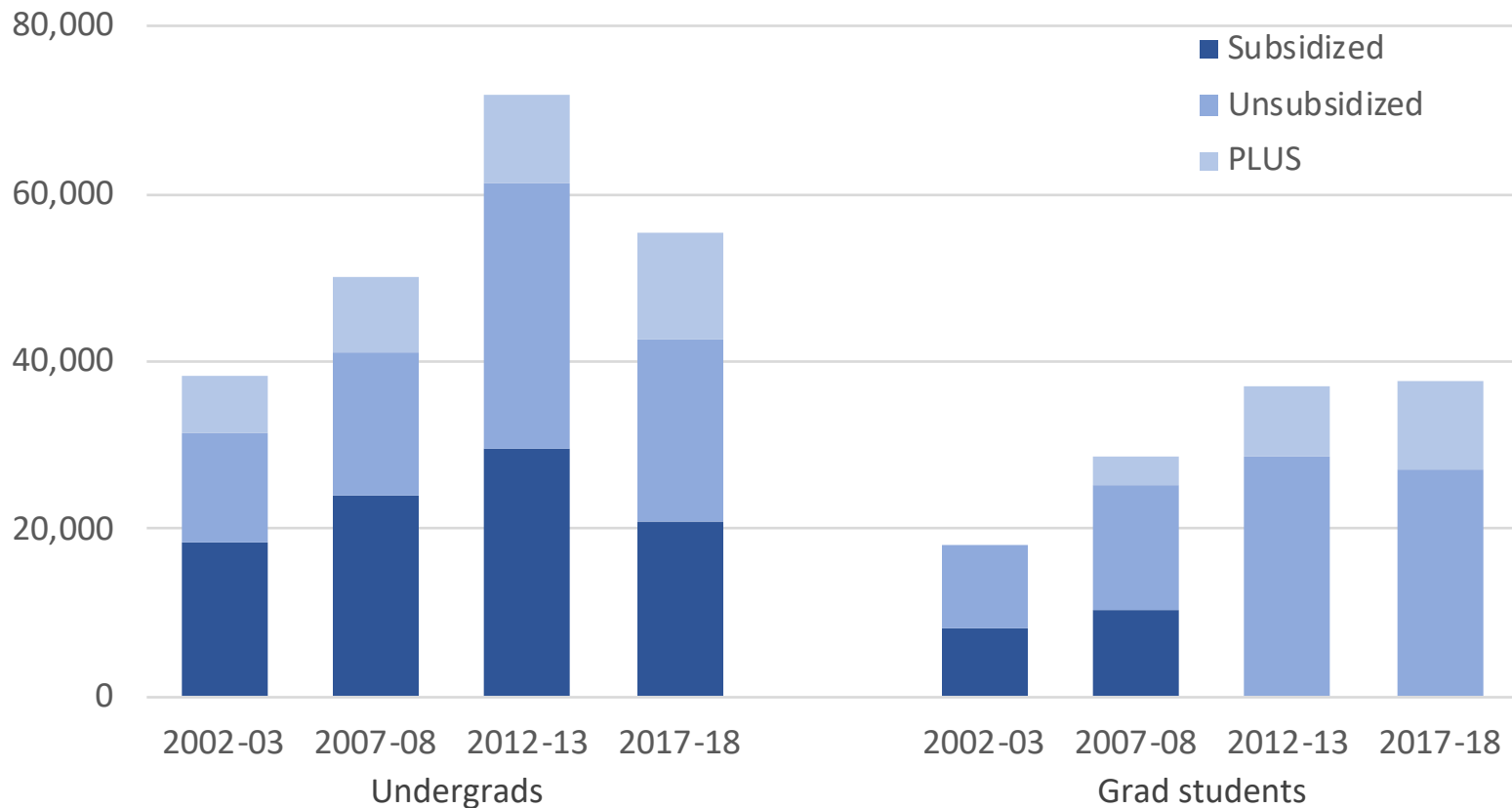
Fewer households in their late 40s and early 50s have debt, but **the share of older households with debt is still material**

Data from [Survey of Consumer Finances](#)

Annual borrowing for undergrads has come down from peak but not for grad students

Total Annual Amount Borrowed

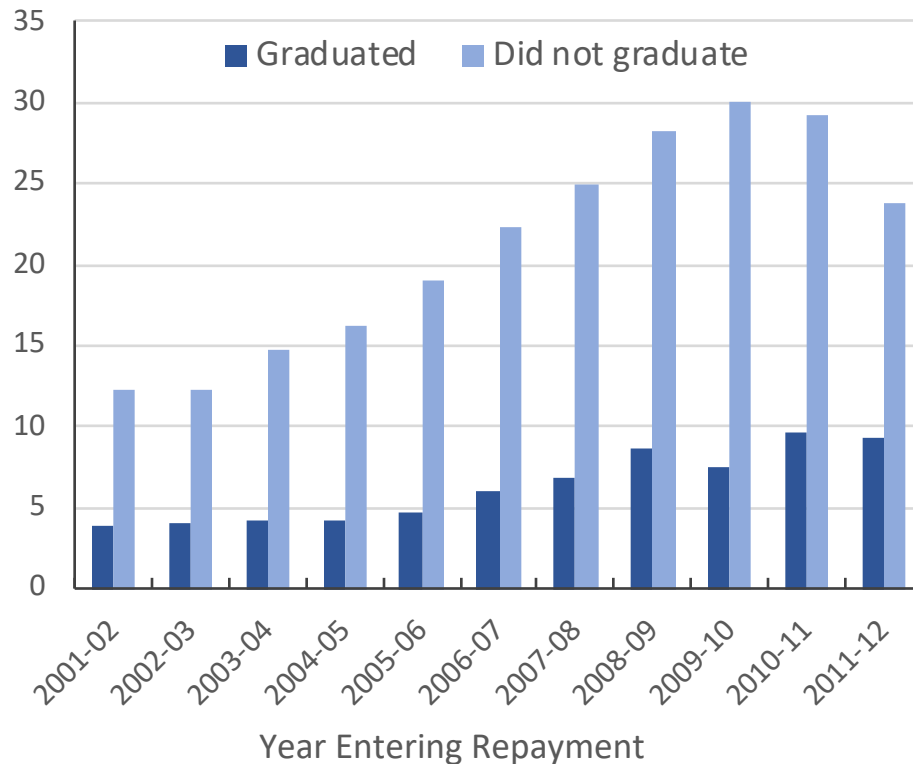
Millions of 2017 dollars



Source: [College Board](#)

Two-year cohort default rates up sharply, particularly for those who did not graduate

Percent



Note. Percent of students who had defaulted on at least one loan two years after starting repayment

Data from [College Board](#)

Research attributes much of the rise in CDRs to the recession and **a change in the composition of borrowers** (really a change in the higher-ed industry as I will discuss later)

[See [Mueller and Yannelis \(2016\)](#) and [Looney and Yannelis \(2015\)](#)]

Generally desirable to have this program

Essential for economic mobility—given the lack of collateral and asymmetric information problems, loan supply from the private market alone would be much too low

Individuals are taking on more debt but the returns to a college degree have increased substantially over the decades

Net return on education still typically higher than that on other investments [[Avery and Turner](#), 2012; [Greenstone and Looney](#), 2011]

The growth in student loans is not likely to result in a 2007/2008-style financial crisis

Much **less debt**—\$1.5T versus \$10T of mortgage debt, not to mention all the derivative products that exposed lenders to risk

The payment **problems are less widespread** among borrowers than was mortgage distress

Because most student loans are government loans, large-scale **default will not hurt private financial institutions**—although they may hurt taxpayers

That said, there are **important other concerns** that can be addressed through better policy

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Large and growing racial disparities

Improving student loan policy

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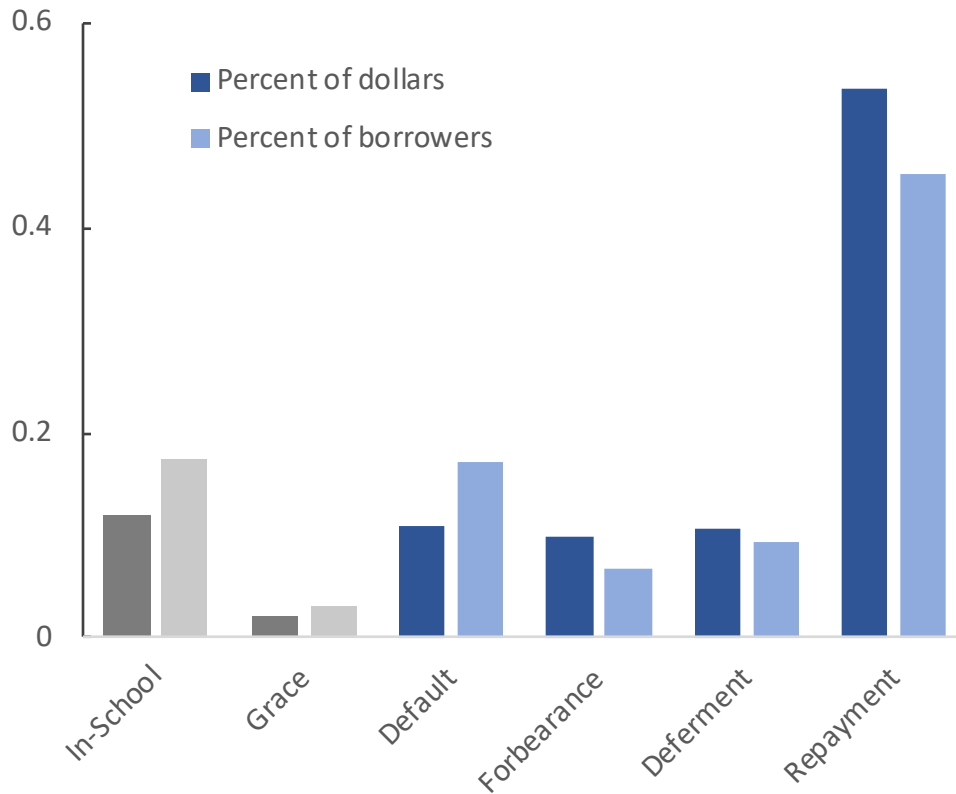
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Student loan default rates grossly understate the struggles of borrowers

Repayment Status of Federal Education Loan Portfolio: 2018:Q2



Borrowers facing hardship may be put into **deferment** or **forbearance**

21% of borrowers are still in school or in their grace period (gray bars)

42% of the remaining borrowers (blue bars) are in default, forbearance, or deferment

Source: [College Board](#)

ALSO

About 1/5 of borrowers (representing 2/5 of balances) are in **income-driven-repayment plans**:

Good that they are avoiding the negative consequences of default

But they are extending their terms and paying more interest

Given forbearance, deferral, and use of IDR plans, it's very important to look at repayment rates as well as default rates

The modest improvement in default rates since their peak in 2010 has coincided with an **increase in the share of borrowers not paying down their loans**

Percent of Borrowers that are Current and Have the Same or Higher Balance than in Previous Quarter	
2012	43.7
2013	46.6
2014	45.9
2015	46.1
2016	47.5
2017	47.5

Data from [Federal Reserve Bank of New York](#)

Some research tries to look beyond financial distress be careful when interpreting

Student loans and homeownership rates—[Mezza, Ringo, Sherlund and Sommer](#) (2016), [Berger and Houle](#) (2015),

Student loans and auto ownership rates—[Kurz and Li](#) (2015)

Much of this research is **comparing former college students without loans to those with loans**

An important consideration is that without the loan, the latter group may not have had access to a college education at all

So it's really important to think about the counterfactual when interpreting this literature

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Background on for-profit colleges

Enrollment share (of institutions in the student loan program) rose from 4% in the late 1990s to a peak of more than 11% in 2010 and has since come back down to 7% [[National Center for Education Statistics](#)]

Growth concentrated in **online institutions** and **chains**

Some valuable features—serve a more disadvantaged population, quicker to innovate, provide education and training in some fields that aren't served by other types of higher-ed institutions [[Deming, Goldin, and Katz, 2012](#)]

But concerns about **predatory practices**, **high tuitions** (and related run-up in debt), **low value-added**

Where Student Loans are Going:

Colleges whose students owe the most, 2000 vs. 2014

For-Profit | Non-Profit or Public

2000		2014	
Institution	Total Debt (Billions)	Institution	Total Debt (Billions)
1 New York University	\$2.2	1 University of Phoenix-Phoenix Campus	\$35.5
2 University of Phoenix-Phoenix Campus	\$2.1	2 Walden University	\$9.8
3 Nova Southeastern University	\$1.7	3 Nova Southeastern University	\$8.7
4 Pennsylvania State University	\$1.7	4 DeVry University-Illinois	\$8.2
5 University of Southern California	\$1.6	5 Capella University	\$8.0
6 Ohio State University-Main Campus	\$1.5	6 Strayer University-Global Region	\$6.7
7 Temple University	\$1.5	7 Kaplan University-Davenport Campus	\$6.7
8 Arizona State University	\$1.4	8 New York University	\$6.3
9 Michigan State University	\$1.3	9 Argosy University-Chicago	\$6.2
10 University of Minnesota-Twin Cities	\$1.3	10 Ashford University	\$5.9
11 Boston University	\$1.3	11 Grand Canyon University	\$5.9
12 The University of Texas at Austin	\$1.3	12 Liberty University	\$5.7
13 University of Florida	\$1.2	13 University of Southern California	\$5.3
14 University of California-Los Angeles	\$1.2	14 Pennsylvania State University	\$5.3
15 University of Michigan-Ann Arbor	\$1.1	15 Arizona State University	\$4.9
16 Columbia University in the City of New York	\$1.1	16 ITT Educational Services Inc System Office	\$4.6
17 University of Pittsburgh-Pittsburgh Campus	\$1.1	17 Ohio State University-Main Campus	\$4.4
18 Indiana University-Bloomington	\$1.1	18 Temple University	\$4.3
19 Rutgers University-New Brunswick	\$1.1	19 DeVry University's Keller Graduate School	\$3.9
20 University of Pennsylvania	\$1.0	20 American InterContinental University-Online	\$3.7
21 University of Arizona	\$1.0	21 University of Minnesota-Twin Cities	\$3.7
22 University of Wisconsin-Madison	\$1.0	22 Michigan State University	\$3.6
23 Florida State University	\$1.0	23 Rutgers University-New Brunswick	\$3.4
24 Virginia Commonwealth University	\$1.0	24 Colorado Technical University-Colorado Springs	\$3.3
25 University of Washington-Seattle Campus	\$1.0	25 Indiana University-Purdue U.-Indianapolis	\$3.1

BROOKINGS

NOTES: This figure ranks institutions by student loans outstanding in 2000 and 2014. For each year, the first column shows the institution name and the second column shows the total volume of student loans outstanding.

SOURCE: US Treasury tabulations of 4 percent NSLDS sample.

[Source: [Looney and Yannelis, 2015](#)]

This is a list of the top 25 colleges in terms of how much student debt they accounted for (2000 and 2014)

Two things to notice:

(1) **The increase in amounts** (top school associated with \$36B in 2014 vs \$2B in 2000)

(2) **The huge rise in for-profit representation** (highlighted in yellow)

More struggles with debt among for-profit borrowers

More likely to take on debt: For undergrads, borrowers per student much higher and originations per borrower a little higher than at other types of institution

Cohort default rates generally higher: 16% of FP borrowers in default 3 years after repayment started versus 7% at private non-profits and 10% at public institutions

Slower repayment of loans: FP degree completers had paid back 43% of loans after 5 years versus 67% for completers at all institutions (26% and 41% for non-completers)

They struggle because of worse labor market outcomes

[Less likely to graduate](#): 26% of students at 4-year FP institutions graduate within 6 years versus 57% at all 4-year institutions

[Looney and Yannelis](#) (2015)—lower median earnings, higher unemployment rates than for students at other types of higher-ed institutions

[Cellini and Turner](#) (2018)—less likely to be employed, 11 percent lower earnings compared with students at public institutions

[Armona, Chakrabarti, and Loveheim](#) (2018)—more loans, higher loan amounts, worse labor market outcomes for 4-year for-profit students

Unconditional results

Controlling for the more disadvantaged backgrounds of for-profit students

Relaxation of lending rules appears to explain much of the rise in for-profit borrower struggles

There are **federal rules** governing the student loan program:

How much can be borrowed and who can borrow

What higher-ed institutions can participate in the student loan program—rules about maximum defaults rates, share of business online, share of revenues coming from federal dollars

[Looney and Yannelis](#) (2018) discuss a loosening of regulations in 1980s, then a tightening (after default rates shot up), then a gradual loosening, and **these cycles turn out to be highly correlated with for-profit entry and subsequent default rates**

Changes in federal regulations

Mid-1980s. Eligibility for federal loans expanded to “independent” borrowers (graduate students and independent undergrads) and students without high school degree; borrowing ceilings were increased.

Looser

1989. Schools cut from program if 2-year CDR > 30% for 3 consecutive years (or > 40% in 1 year); no more than 85% revenue of for-profit schools could come from federal aid; no more than 50% of students could be doing “distance” or online education.

Tighter

Late 90s. CDR threshold lowered to 25%; but, eligibility expanded, longer period of non-payment needed to count as “default,” for-profit schools could have up to 90% of revenues from federal aid.

Mixed

Mid 2000s. 50 percent distance rule eliminated; PLUS loans expanded to grad students; loan limits increased.

Looser

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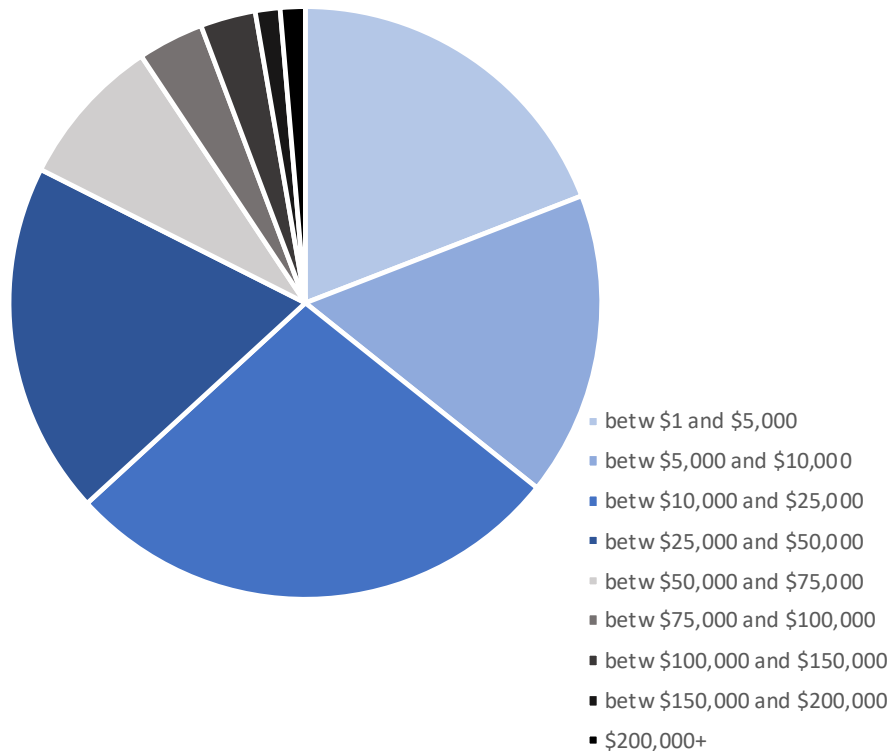
For-profits

High-balance borrowers

Large and growing racial disparities

Improving student loan policy

Distribution of Student Loan Borrowers by Balance: 2017Q4



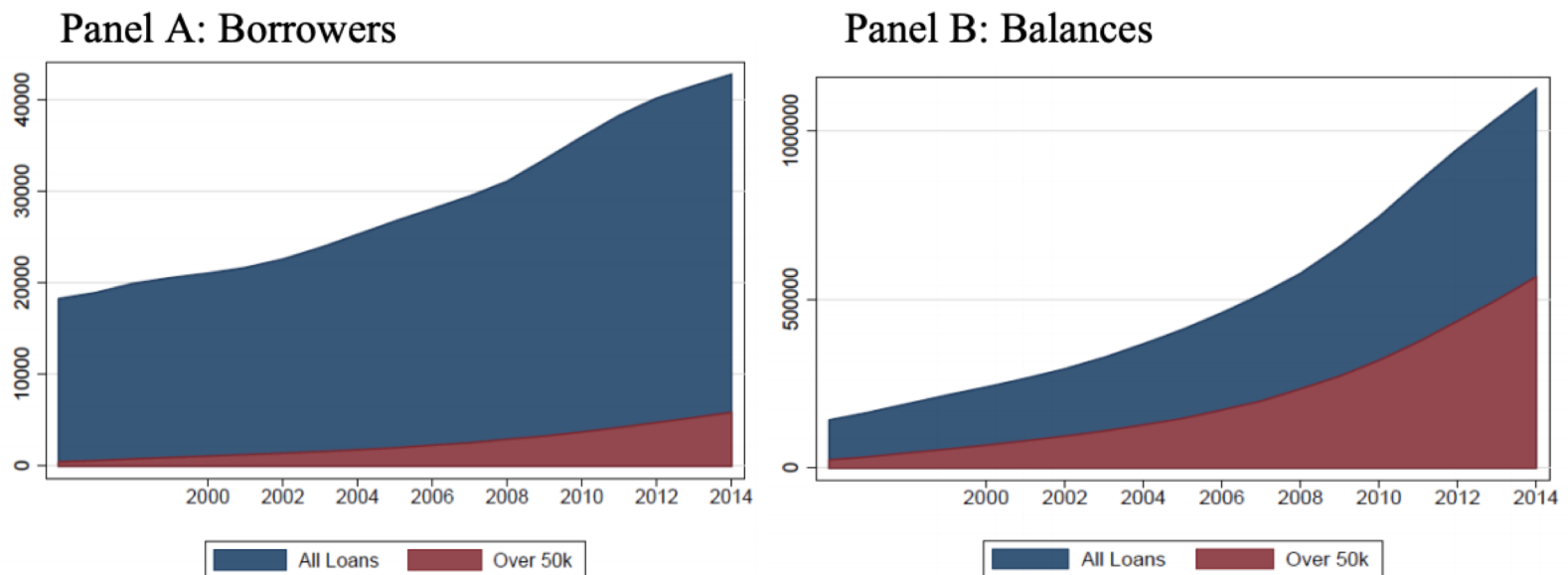
Most student loan borrowers have modest amounts of debt— $\frac{2}{3}$ had debt less than \$25,000 in 2017 (blue segments) [[Federal Reserve Bank of New York](#)]

But the $\frac{1}{8}$ of borrowers who owed more than \$50K in 2014 (dark gray segments) accounted for $\frac{1}{2}$ of aggregate balances [[Looney and Yannelis, 2018](#)]

Data from [Federal Reserve Bank of New York](#)

The share of borrowers with balances over \$50K (in 2014 dollars) rose from 5% to 14% between 2000 and 2014

Their share of balances has also increased considerably



Screenshot from [Looney and Yannelis \(2014\)](#); dollar figures cited and charted are in 2014 dollars

Characteristics of high balance borrowers

Generally have **higher earnings** than low-balance borrowers

61% of high balance borrowers in 2014 had taken out loans to attend **grad school** [down from 74% in 2000]

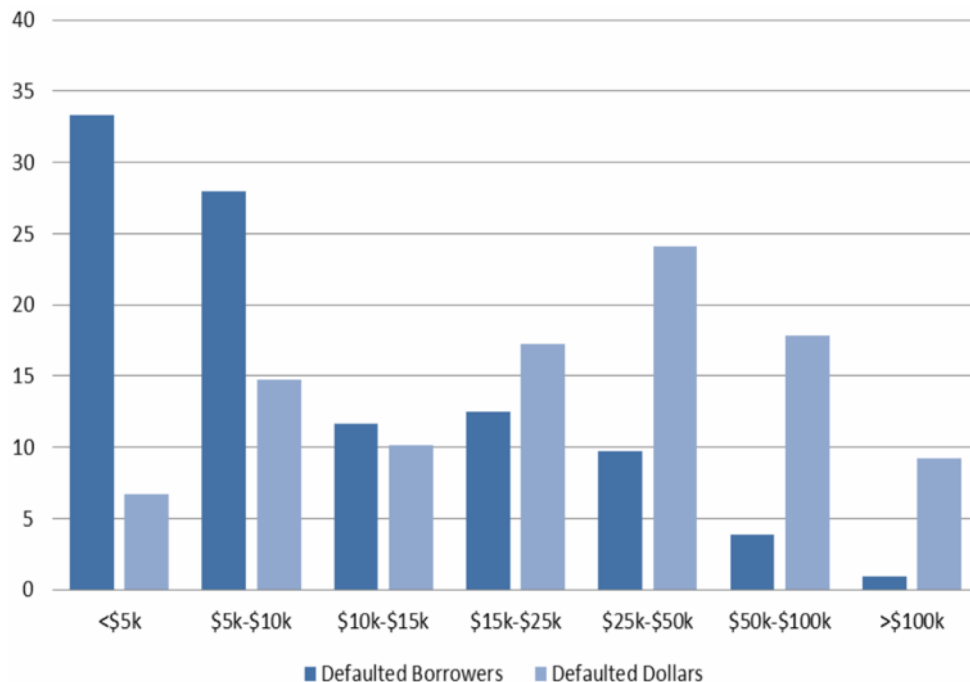
Parent PLUS borrowers represented 10% of high balance borrowers in 2014, up from 6% in 2000

Share borrowing to attend a **for-profit institution** was 15% in 2014, up from 5% in 2000

Source: [Looney and Yannelis](#), 2018

High balance borrowers tend to earn more income so less likely to default, but they disproportionately account for the \$s in default

Share of Borrowers and Dollars in Default



Screenshot from [Looney and Yannelis, 2018](#)

Moreover, the situation is worsening over time—**repayment rates have slowed more markedly** than for smaller-balance borrowers [[Looney and Yannelis, 2018](#)]

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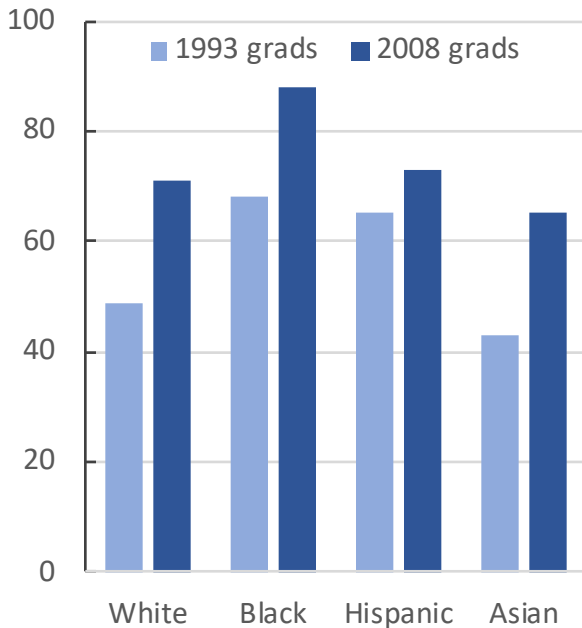
Large and growing racial disparities

Improving student loan policy

Large and growing racial disparities in loan amounts, loan outcomes

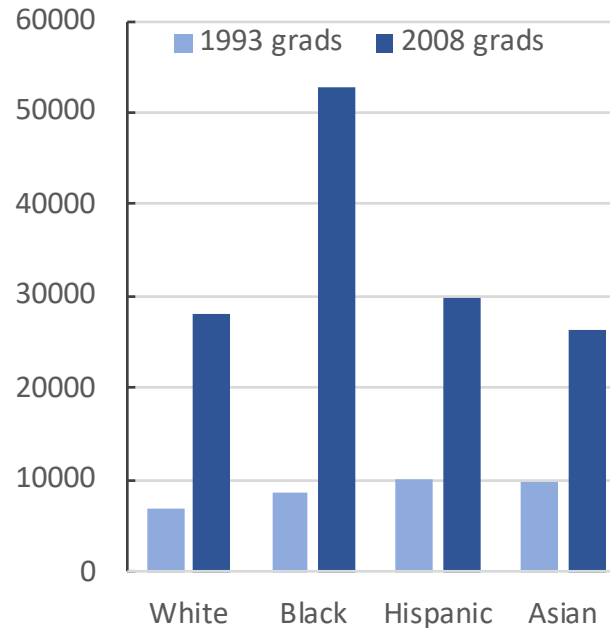
Have Debt 4 Yrs after Graduation

Percent



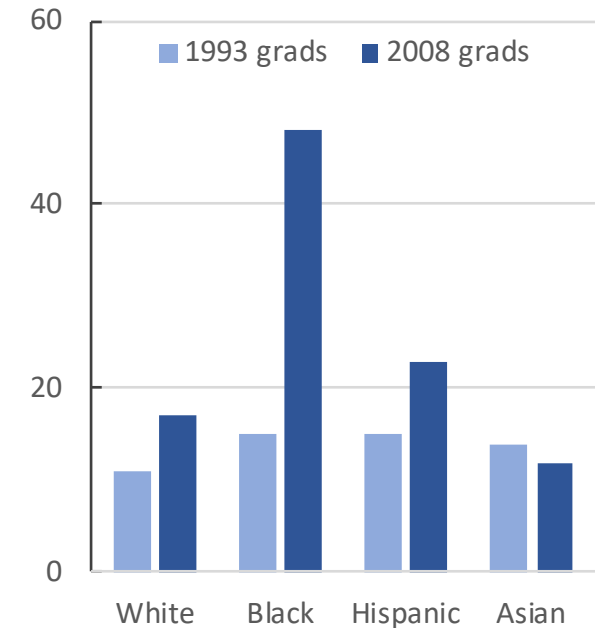
Average Debt 4 Yrs after Graduation

2012 Dollars



Owed More than Borrowed 4 Yrs after Graduation

Percent



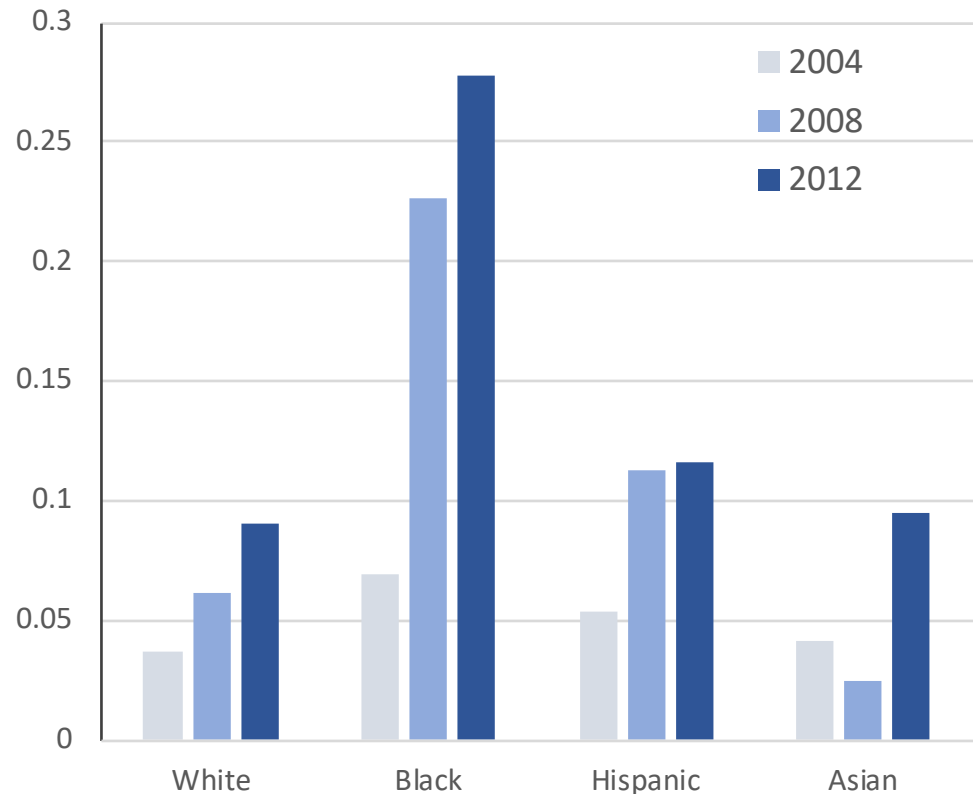
Data from [Scott-Clayton and Li \(2016\)](#)

Again some relationship to for-profits

Black graduates are more likely to have enrolled in graduate school within 4 years than white (47% versus 38%)

But more than ¼ of black graduate students are at for-profits

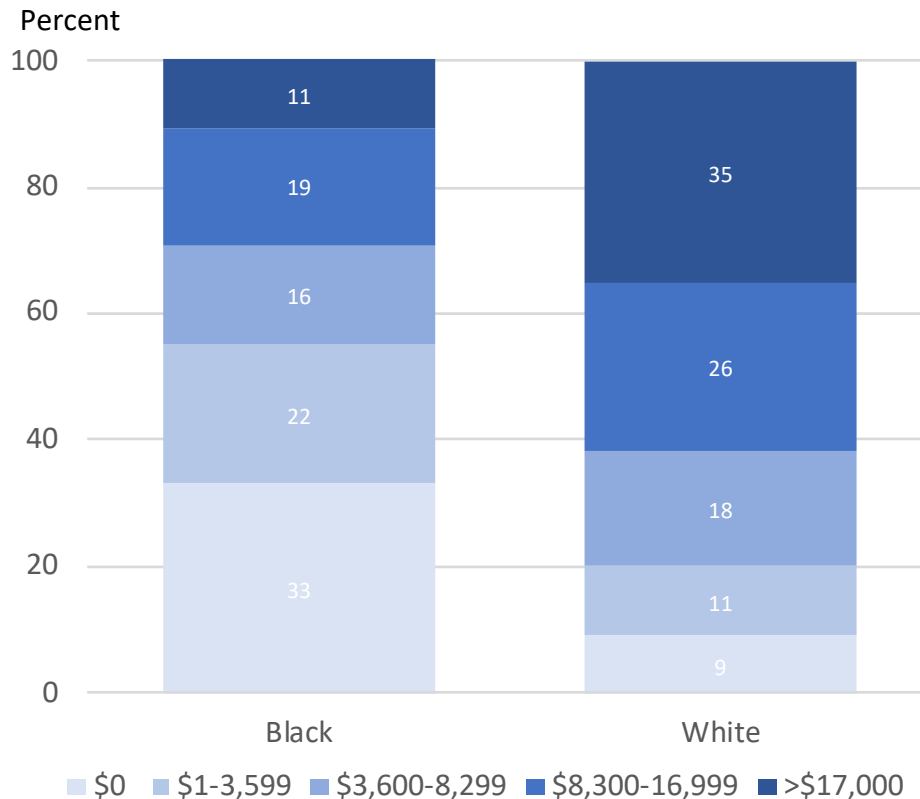
Share of Graduate Students in Different Race Groups Enrolled at For-Profit Institutions



Data from [Scott-Clayton and Li \(2016\)](#)

Higher share of problematic Parent PLUS loans for Black borrowers

Parent PLUS Loan Borrowers by "Effective Family Contribution" to Cost of College



Arguably, no family with a zero EFC should take on a PLUS loan, as EFC is a rough approximation of the ability to repay a loan

[Fishman](#) (2018)

(Share is too high for other groups too)

Data from [Fishman](#) (2018)

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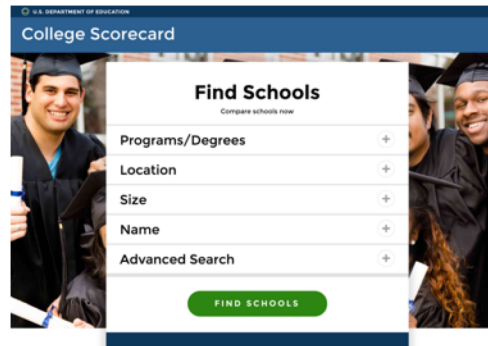
Improving student loan policy

Different types of policies

Policies to **relieve struggling student borrowers**

Policies to **impose accountability on higher-ed institutions**

Somewhere in between—[College Scorecard](#) which helps students, and helps with accountability



Current policy to relieve struggling borrowers is the **income-driven-repayment program**

Evidence that these plans do help borrowers avoid default [Mueller and Yannelis](#) (2019)

But **the IDR program has limitations:**

Administratively burdensome—borrowers have to recertify their information every year (documentation of family income, family size)

Based on previous year's income—doesn't help when it really might matter (e.g. when you've lost your job)

Inconsistent application across servicers

Ideas to address these IDR limitations

Switch to a system of **payroll withholding** (as in UK, Australia) as [Dynarski](#) has advocated:

- Avoids need for cumbersome paperwork

- Automatically adjusts with your earnings

- Takes loans servicers out of the process

Some trade-offs—would be at the individual, not household level (more potential for moral hazard); would prioritize loan payments over other uses of earnings

Could do **more modest step: switch to two-year recertification**

Could **“go big”**: make this the default payment plan

Also IDR has some problems when it comes to high-balance borrowers

Generally, **high-balance borrowers (many of whom have high earnings) benefit disproportionately from IDR**, especially given the potential for remaining balances to be forgiven after 20-25 years of reasonable payments

[Looney \(2018\)](#) example: orthodontist with \$1 million now in loans, earning \$255K per year, \$400K home, Tesla, paying only \$1,600 a month and **on track to have \$2 million in loans forgiven after 25 years**

Not clear how to fix this problem—but limiting the size of grad PLUS loans would be a starting point

Current policies to impose accountability

Schools with **high cohort default rates** (30% for 3 years, 40% in 1 year) risk losing access to the program

Schools limited to no more than 90% of revenues from federal aid (**90/10 rule**)

Borrower Defense Rule—*protections for borrowers who have been defrauded (Obama regulation; current Administration weakening)*

Gainful Employment Rule—*schools with systematically high debt-to-earnings risk losing access (Obama regulation; current Administration has announced it will rescind)*

I hope I have persuaded you that these accountability measures are not enough

Growing body of evidence that certain schools (especially in the for-profit sector) consistently deliver low-value educations to their students

First order of business is don't weaken Borrower Defense Rule and **don't rescind Gainful Employment Rule** [see recent [Black, Cellini, Deming, Dynarski, Looney, Matsudaira, Rothstein](#) letter to the Dept of Education]

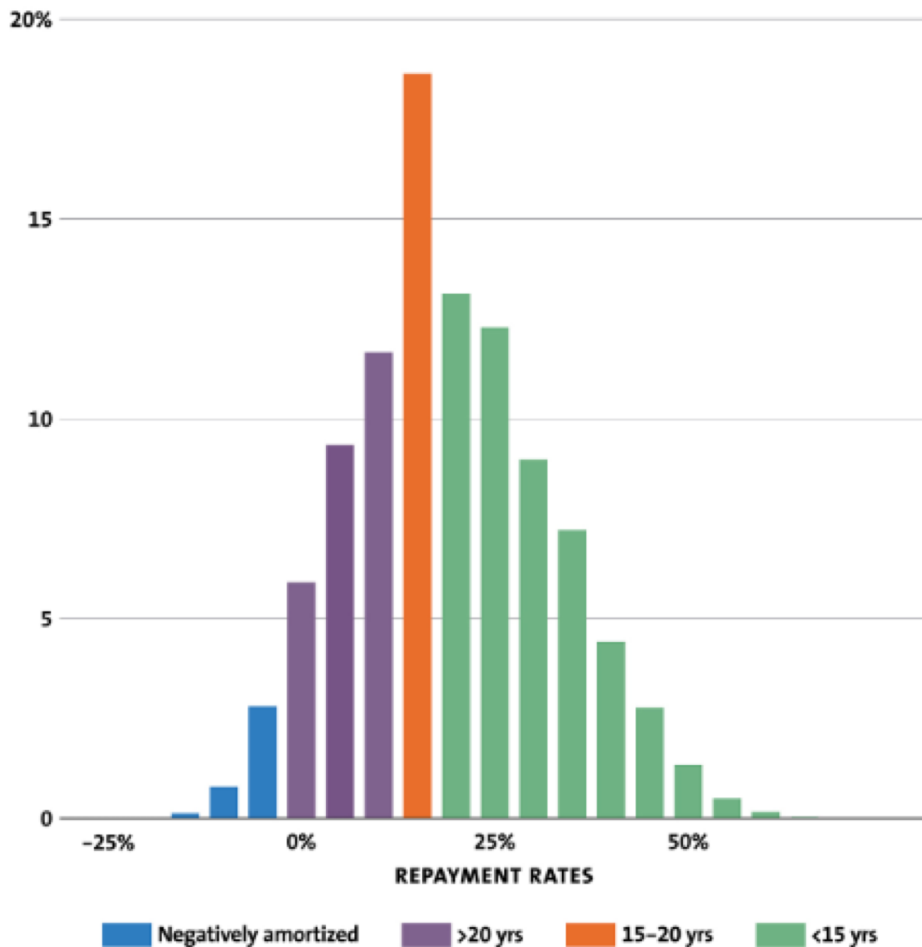
Also consider **reversing some of the relaxation of standards** that occurred in the last decade, e.g. allowing fully on-line institutions [evidence that [1/3 of rise in defaults due to online schools](#)]

Important limitation regarding current accountability focus on default rates

As discussed earlier, cohort default rates understate borrower struggles—partly because our IDR program masks them!

To address this limitations, we need to **sanction schools based on repayment rates**

Distribution of 5-Year Repayment Rates Across Institutions (for 2009 cohort)



[Looney and Watson](#)

(2018) evidence:

For 5% of schools, the borrowers collectively owe more than they borrowed 5 years after graduation (blue bars)!

For another 32%, the borrowers collectively won't pay off their debt in 20 years (purple bars)

Weighted by undergrad borrower count

A “risk-sharing” program based on repayment rates

[Chou, Looney, and Watson](#) (2017):

Assess schools based on **cohort repayment rates**

For schools where borrowers collectively not on track to repay loans in 15 years, impose **continuum of penalties depending on how badly schools perform**

Essentially requiring poor-performing schools to pay back some of loans that are not being repaid

A “risk-sharing” program based on repayment rates

Part of the idea is to **protect taxpayers**

But **incentivizing schools to provide more value-added**—match students better with programs, teach better, encourage graduation, assist with job placement

In addition to being based on a better metric, an advantages of this proposal relative to current CDR measure is that the **continuum means you aren’t just penalizing schools with extremely poor outcomes (more general incentive, less potential to game)**

Central tension with all of the accountability measures

The schools that have worse loan performance are generally the ones that serve the most disadvantaged students

How do you balance access to credit (and economic mobility!) with the financial risks to the federal budget and the students themselves?

Spurred much contentious debate when I was in the Administration

Central tension with all of the accountability measures

So, important to think about **carve-outs or rewards for schools serving low-income students** or other underserved populations as you design these measures

Some perhaps comforting evidence from [Cellini, Darolia, and Turner](#) (2016)—sanctions on for-profits in 1990s led to 40% drop in enrollment but most students absorbed by public-sector schools (only 3% drop in market enrollment)

Forgiving student loan debt

[Recall that some forgiveness already built into the IDR program]

Some bigger proposals out there—most recently from [Senator Warren](#)

Likely to hear more about it as the 2020 campaign heats up; understandable given that some people feel ill-served by the system

Hard questions include how do you avoid the plans being regressive, how do you make sure the money is going to the truly needy, how do you avoid moral hazard

Questions?