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UPDATED: APRIL 2021

Making Income-Driven Repayment More Affordable

More than two decades ago, Congress created the Income-Driven Repayment (IDR) system to protect student loan borrowers from financial hardship by providing them with an option to continue repaying their debt, while also lowering their monthly payment depending on income-levels. Currently, there are 8.5 million borrowers enrolled in the four IDR plans administered by the Department of Education: Income-Contingent Repayment (ICR), Income-Based Repayment (IBR), Pay As You Earn (PAYE), and Revised Pay As You Earn (REPAYE).[i]

Unlike the standard 10-year repayment plan, that borrowers are automatically placed into and under which they pay the same amount for each installment period, a student loan holder must affirmatively choose to enroll in an IDR plan, and recertify their income every year to continue in the program. Under these plans, a borrower's monthly payment is determined based on their income and after either 20 or 25 years of repayment, the remaining balance of the loan is cancelled. Monthly payments are set at 10 or 15 percent of discretionary income, which is typically defined as income above 150 percent of the federal poverty guideline. Enrollment in IDR is also a prerequisite for borrowers wishing to participate in the Public Service Loan Forgiveness (PSLF) program.

Concerns with Structure and Implementation

As with most loan repayment or forgiveness programs, the intent of IDR is to protect student loan borrowers from the harmful financial effects of unaffordable debt by ensuring that it does not remain a burden throughout their lives, with the long-term purpose of addressing overall inequities in wealth. However, because of certain elements in the design of both IDR itself and the federal student loan system as a whole, the program's implementation has led to a series of unintended consequences, which have left it short of meeting its promise.

Recent data show that since the enactment of the first IDR program nearly 25 years ago, of the approximately two million borrowers who have been eligible to have their loans canceled through an IDR plan, just 32 have ever received forgiveness.[ii] Much of this is due to complexities within the program—including the existence of multiple plans, which further increase confusion—lack of consistent communication from the Department of Education and its loan servicers, clerical errors causing borrowers to lose credit for qualifying payments made, and burdens placed on the borrowers to affirmatively continue annual income recertification. Additionally, underlying flaws in the program's design have also made it a much less effective tool for managing student loan debt.

Due to the way payment amounts under IDR are calculated, most borrowers only pay a portion of their interest each month without actually touching the principal of their loan. Any unpaid interest is then added to that principal, which increases the overall outstanding amount due. Interest is then charged on that higher principal balance, increasing the overall cost of the loan. With the monthly payment not being enough to cover the full interest, the balance negatively amortizes, with the amount owed increasing even as payments are made. This essentially traps borrowers in a vicious cycle, significantly increasing the amount of debt carried by all students enrolled in IDR, but particularly for graduate students, who have higher interest rates and also do not have access to federal subsidized loans. Higher interest rates, combined with negative amortization, increase the overall cost of IDR programs for both students and the federal government.[iii]

Furthermore, under certain IDR plans, graduate students are placed into a longer repayment schedule before the balance of the loan is forgiven. This turns IDR into a "degree," rather than an "income" based program, under the assumption that all graduate degree holders will be "high-income" earners. Data show that this is not necessarily the case, particularly for those in public service, including in mental and behavioral health care fields, where an advanced degree is a requirement at entry level.[iv]

Finally, unlike certain loan forgiveness programs, such as PSLF, any loan debt that is canceled under IDR carries a tax liability. This means that after years of repayment, when borrowers finally reach the point when a portion of their debt will be forgiven, they will be forced to pay a sizeable tax, further adding a hidden cost to the program. If the purpose of debt cancellation is to provide the borrower with a financial benefit, taxing that forgiveness clearly undermines its intent.

Despite the variety of issues and concerns with both its design and administration, if action is taken to make meaningful reform, IDR can still be a very useful program that lives up to its intended purpose.

Policy Recommendations

- **Streamline and simplify.** Several steps must be taken to make the program more succinct, manageable, accessible, and easier for borrowers to navigate:
    - Consolidate all existing IDR plans into single program, which sets monthly repayments at 10 percent of discretionary income and provides loan cancellation after 20 years of repayment.
    - All types of federal loans—Direct, FFEL, and Perkins—should qualify.
    - Reduce or eliminate administrative barriers and unnecessarily burdensome paperwork.
    - Institute an automatic annual income recertification process to allow for continued enrollment in IDR.
    - Ensure that borrowers who consolidate their loans do not lost credit for qualifying payments made prior to consolidation.

- **Ensure that IDR remains "income-based."** Irrespective of degree type—undergraduate or graduate—all borrowers enrolled in IDR should have their debt cancelled after 20 years of repayment. This would ensure that the program remains truly based on income.

- **Treatment of interest capitalization and accrual.** Eliminating capitalization of unpaid interest would stop the exponential increase of student loan balances that are already in repayment and prevent them from negatively amortizing under IDR. Additionally, interest accrual should be lowered for borrowers enrolled in the program.

- **Codify tax-free loan cancellation.** Any debt forgiven under IDR must not impose a tax liability on the borrower. This change would align IDR with other Department of Education student loan repayment programs, such as PSLF. The 5-year tax holiday for student loan forgiveness enacted in the American Rescue Plan Act should be made permanent for all current and future student loan repayment programs.

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[i] U.S. Department of Education. Office of Federal Student Aid. Federal Student Loan Portfolio. Retrieved from: https://studentaid.gov/data-center/student/portfolio.

[ii] National Consumer Law Center Student Loan Borrower Assistance & Student Borrower Protection Center. (March 2021). Education Department's Decades-Old Debt Trap: How the Mismanagement of Income-Driven Repayment Locked Millions in Debt. Retrieved from: https://protectborrowers.org/wp-content/uploads/2021/03/IDR-Brief-NCLC-SBPC.pdf.

[iii] Congressional Budget Office. (February 2020). Income-Driven Repayment Plans for Student Loans: Budgetary Costs and Policy Options. Retrieved from: https://www.cbo.gov/system/files/2020-02/55968-CBO-IDRP.pdf.

[iv] U.S. Department of Labor, Bureau of Labor Statistics. (2020). Occupational Outlook Handbook, Psychologists, 2018-2028. Retrieved from https://www.bls.gov/ooh/life-physical-and-social-science/psychologists.htm#tab-6