

TO: Interested Parties
 FROM: The Institute for College Access & Success (TICAS)
 DATE: February 18, 2015
 RE: Pay As You Earn recommendations for upcoming negotiated rulemaking process

This memo lays out TICAS’ regulatory recommendations to improve the Pay As You Earn (PAYE) federal student loan repayment plan through the negotiated rulemaking session beginning February 24-26, 2015.¹ The recommendations detailed below would increase PAYE access, simplicity and fairness, as well as better target benefits to those who need them the most. The lists of other organizations that support each recommendation are illustrative only and not exhaustive lists. Many of these changes would improve other existing income-driven repayment plans (Income-Based Repayment (IBR) and/or Income-Contingent Repayment (ICR)) as well, but legislative changes would be required to implement them for IBR unless otherwise noted.

Any questions about this memo may be directed to Pauline Abernathy, Diane Cheng, or Jessica Thompson at (510) 318-7900.

Regulatory recommendations to improve PAYE access, targeting, simplicity and fairness:

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¹ These and other recommendations were included in TICAS’ October 2014 public comments, available at http://www.ticas.org/files/pub/TICAS_Oct_2014_Neg_Reg_Comments.pdf.

Eliminate time limitations for when borrowers must have taken out loans to be eligible for PAYE

(supported by California State Student Association, Consumers Union, Generation Progress, Obama Administration, Project on Predatory Student Lending, Young Invincibles)

The complex “new borrower” requirement for PAYE should be eliminated. Currently, Direct Loan borrowers are only eligible for PAYE if they took out their first federal loans on or after October 1, 2007 and also received a loan disbursement on or after October 1, 2011. This timing restriction adds complexity to the plan in terms of communication and administration, and confusion for borrowers about their eligibility for PAYE and income-driven repayment (IDR) plans generally. Although all borrowers with Direct Loans and/or Federal Family Education Loans (FFEL) already have access to Income-Based Repayment (IBR), many are unaware of the option; and for those with Direct Loans who borrowed before July 1, 2014,² PAYE would provide lower monthly payments and a shorter repayment period than IBR. Making all Direct Loan borrowers eligible for a plan that caps payments at 10% of income and discharges any remaining debt after 20 years of payments will be a major step towards improving and simplifying repayment options, outreach, and enrollment.

Better target the benefits of PAYE

The current design of PAYE can substantially reduce monthly payment amounts for low- and moderate-income borrowers, helping them stay on top of their payments and avoid default.³ However, it can also allow some high-debt, high-income borrowers to pay a smaller share of their incomes than other borrowers and receive substantial loan forgiveness when they could have afforded to pay more. There is now broad bipartisan support for better targeting the benefits of PAYE, but differing approaches in how to do it.

To better target the benefits of PAYE to borrowers who need them most, we propose:

1. Removing the 10-year “standard” payment cap, and
2. Gradually phasing out the income exclusion for borrowers with high incomes.

For all borrowers, monthly payments would never be greater than 10% of their total income. Both changes would be based on borrowers’ debt relative to their income, unlike other targeting proposals that focus solely on borrowers’ debt amounts without factoring in their income or ability to repay. We explain these changes in more detail below, and Appendix A shows how sample borrowers would be affected by these changes.

Currently, the monthly payment for PAYE is calculated as 10% of the borrower’s “discretionary income,” up to but not exceeding the 10-year standard payment (also known as the “permanent standard”) amount:

² Students who took out their first federal loan on or after July 1, 2014 also have access to a new version of Income-Based Repayment (IBR), where monthly payments are capped at 10% of discretionary income (rather than 15%) and any remaining balance is forgiven after 20 years of qualifying payments (rather than 25 years). It is very similar to PAYE but not identical.

³ TICAS. November 2, 2012. Blog post. “New Pay-As-You-Earn Plan Will Make Loan Payments More Affordable for Borrowers with Modest Incomes.” <http://views.ticas.org/?p=937>.

- Discretionary income is defined as the borrower’s adjusted gross income (AGI) minus an “income exclusion” of 150% of the poverty level for the borrower’s household size and state.
- The “standard payment” is the monthly amount the borrower would have had to repay if she had entered a fixed 10-year repayment plan (often referred to as the “standard” plan) with what she owed when she entered PAYE. The standard payment currently functions as a cap on monthly payment amounts in PAYE.

Remove the 10-year standard payment cap

(supported by Consumers Union, Obama Administration, New America, Young Invincibles)

The way monthly payments are capped in PAYE (and IBR) results in some high-income borrowers paying a smaller share of their income than lower income borrowers. This is because borrowers whose incomes rise above their debt to the point where they must start paying the 10-year standard amount are, by definition, paying a smaller share of their discretionary income than borrowers making income-driven payments (i.e., less than 10% of their discretionary income).

We join the Obama Administration, Republicans and Democrats in Congress, and others in recommending the elimination of the standard payment cap so that borrowers in IDR plans are always making payments based on their income.⁴ Having borrowers with high incomes make larger monthly payments better targets benefits by preventing high-debt, high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.

Removing the standard payment cap necessitates additional regulatory changes to the required payment amount for borrowers who do not submit their annual income documentation on time. Currently in PAYE, borrowers with a PFH who do not update their income documentation on time are required to pay the 10-year standard amount, which will always be higher than their prior income-driven payment amount.⁵ However, once the standard payment cap is removed, the 10-year standard amount may be *lower* than borrowers’ income-driven payment amount. To avoid rewarding borrowers who fail to submit updated income documentation, borrowers who do not submit their annual income documentation on time should be required to pay the *greater of* the 10-year “standard” amount or their previous income-driven payment amount (based on the last set of income documentation they provided).

Additionally, we support legislative changes to prevent any payments made without income documentation from counting toward forgiveness. Borrowers in PAYE who do not update their income information should not have their monthly payments count toward forgiveness until they provide the required income documentation and resume making income-driven payments. This legislative change is needed because with the regulatory change above removing the standard

⁴ For example, see U.S. Department of Education. 2015. *Student Loans Overview: Fiscal Year 2016 Budget Proposal*. <http://www2.ed.gov/about/overview/budget/budget16/justifications/r-sloverview.pdf>; Higher Education Affordability Act (S. 2954), introduced November 20, 2014, <http://1.usa.gov/1HrgE1g>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://1.usa.gov/1AU7U2t>. See also HCM Strategists, IHEP, NASFAA, New America Foundation, and Young Invincibles. 2014. *Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk*. <http://bit.ly/1fLBIOK>.

⁵ Currently in PAYE, borrowers who no longer have a PFH are not required to submit annual income documentation because their monthly payment amount is already the permanent standard amount, which is not based on their income. These borrowers are, however, annually notified of the option to ask their servicer to recalculate their payments if their financial circumstances have changed. 34 CFR 685.209(a)(5)(iv).

payment cap, borrowers who fail to submit updated income information may end up paying less than if they had documented their income as required. Therefore, allowing payments made in the absence of income documentation to count toward forgiveness could lead to some borrowers receiving forgiveness under PAYE or Public Service Loan Forgiveness (PSLF) sooner than they should. Counting only those payments made *with* income documentation toward forgiveness requires statutory changes to 20 USC 1087e(e) and 20 USC 1087e(m).

Gradually phase out the income exclusion for high-income borrowers

(supported by Young Invincibles)

The Obama Administration and some members of Congress have suggested further targeting the benefits of PAYE by extending the repayment period to 25 years for borrowers with balances over \$57,500. As discussed below, this significantly increases the total amount that borrowers have to repay if they have debts over \$57,500, regardless of their incomes. We recommend an alternative approach that considers the borrower's income and avoids abrupt "cliffs" where borrowers in very similar financial situations get very different benefits.

Specifically, we propose gradually phasing out the income exclusion for borrowers with AGIs over \$100,000. Borrowers with incomes above this level can afford to spend a larger share of their total income on loan payments and still have sufficient funds to cover basic necessities, such as food and housing. By phasing the exclusion out gradually, our proposal avoids creating a cliff where \$1 more in income would result in a huge change in the monthly payment amount. The AGI level at which the income exclusion phase-out begins would be indexed to inflation, so it does not decline in real value over time.

The income exclusion would remain 150% of poverty up to an AGI of \$100,000. In the borrower examples in Appendix A, the income exclusion is reduced by one percentage point for each \$1,000 of AGI above \$100,000, until completely phased out at \$250,000 AGI. For example, at an AGI of \$101,000, the income exclusion would be 149% of poverty; at an AGI of \$102,000, the income exclusion would be 148% of poverty; and so forth until it reaches 0% at an AGI of \$250,000. The rate could be adjusted to make the income exclusion phase out more quickly and within a smaller income range (e.g., two percentage points per \$1,000 above \$100,000 AGI, zeroing out at \$175,000 AGI).

Keep the maximum repayment period at 20 years

(supported by AFT, California State Students Association, Consumers Union, Generation Progress, US PIRG)

Currently in PAYE, any debt remaining after 20 years of qualifying payments is discharged, though many borrowers will repay their loans in full before the 20-year period is over. We recommend retaining this 20-year maximum repayment period for all borrowers in PAYE.

Research has shown that carrying outstanding student debt may affect borrowers' ability and willingness to make other financial commitments, such as buying a home or a car, enrolling in graduate school, opening a small business, saving for their children's education, or saving for their own retirement.⁶ For example, one recent survey found that nearly one-third of parents with

⁶ Consumer Financial Protection Bureau (CFPB). 2013. *Student Loan Affordability: Analysis of Public Input on Impact and Solutions*. http://files.consumerfinance.gov/f/201305_cfpb_rfi-report_student-loans.pdf. Federal Reserve Bank of New York. April 17, 2013. "Young Student Loan Borrowers Retreat from Housing and Auto Markets."

student debt say that paying their debt has prevented them from saving for their children's higher education (31%) or their own retirement (32%).⁷ Student debt can affect borrowers' access to other credit, and the need to set aside money for student loan payments ties up funds that could have been used in other ways.⁸ Capping loan repayment periods at 20 years would help borrowers focus on saving for retirement and their children's education before the next generation is in college. A recent report from the Government Accountability Office found that the number of older Americans with outstanding student debt has significantly increased in the last four years alone, and that their debt is more likely to be in default.⁹ Delaying forgiveness in PAYE would make this problem even worse.

Complexity and Cliffs: the problems with extending the repayment period for borrowers with higher debt levels. Proposals to extend the PAYE repayment period to 25 years for borrowers with debt above a certain threshold¹⁰ would introduce more complexity into the program and create abrupt "cliffs" where borrowers in very similar financial situations get very different benefits. Having different repayment periods based on debt levels would complicate both the communication and implementation of PAYE.

Using a debt threshold to determine the repayment period can have particularly harsh consequences for borrowers near the specified threshold, because those with debt \$1 above the threshold can be subject to a substantially longer repayment period than those with debt just \$1 below the threshold. For example, the Obama Administration's FY 2016 Budget proposed extending the PAYE maximum repayment period to 25 years for borrowers with more than \$57,500 in debt.¹¹ Consider the cliff effect for a single borrower who earns \$45,000 in adjusted gross income (AGI), and whose income increases 4% a year. If she has \$57,500 in federal student loan debt, she will pay \$90,000 after 20 years—her entire loan principal plus \$32,500 in interest. However, *if she owes one dollar more, she will pay \$128,100 in total--\$38,100 or 42% more.*

<http://bit.ly/1izd1Jw>. Kim, Dongbin and Therese S. Eyermann. 2006. "Undergraduate Borrowing and Its Effects on Plans to Attend Graduate School Prior to and After the 1992 Higher Education Act Amendments," *Journal of Student Financial Aid* 36(2): Article 1. <http://publications.nasfaa.org/jsfa/vol36/iss2/1>.

⁷ Certified Financial Planner Board of Standards, Inc. September 17, 2014. Press Release. "American Parents Struggle to Save for Higher Education, Manage Living Expenses." <http://bit.ly/1sJti5A>.

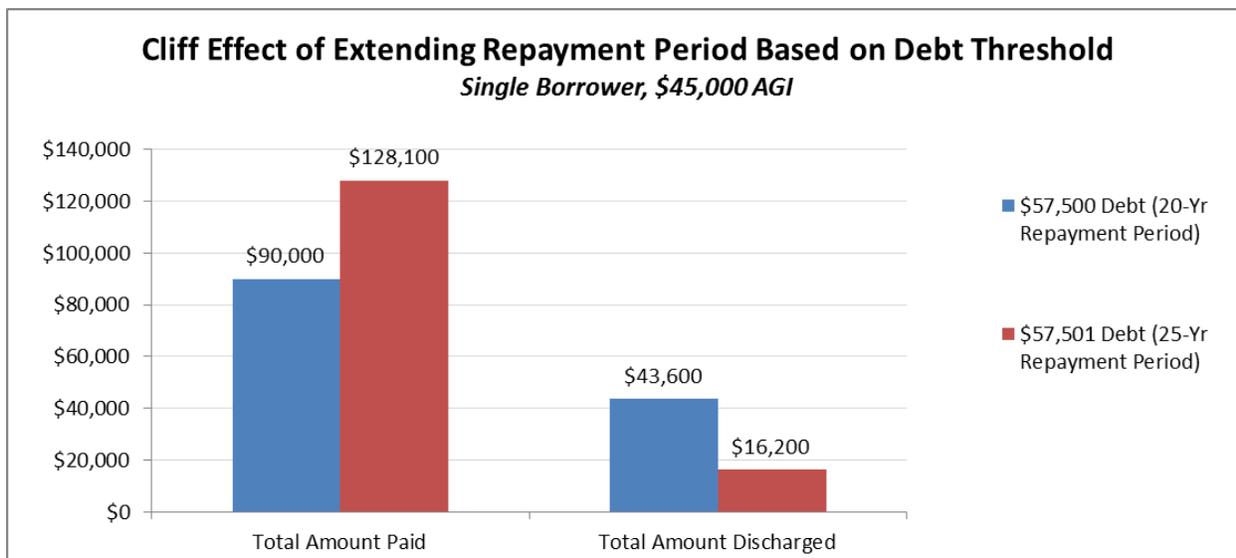
⁸ Raskin, Sarah Bloom. Deputy Secretary of the U.S. Treasury. September 29, 2014. Remarks at the Annual Meeting of the National Association of Business Economics (NABE). <http://www.treasury.gov/press-center/press-releases/Pages/jl2652.aspx>. Lee, Donghoon. Federal Reserve Bank of New York. 2013. Presentation for Press Briefing. "Household Debt and Credit: Student Debt." <http://www.newyorkfed.org/newsevents/mediadvisory/2013/Lee022813.pdf>.

National Association of Realtors. June 18, 2012. Blog post. "Impact of Student Debt on Future Housing Demand." <http://bit.ly/1uGUD4S>. Young Invincibles. 2012. *Denied? The Impact of Student Debt on the Ability to Buy a House*. <http://bit.ly/KhNurq>.

⁹ Jeszeck, Charles. U.S. Government Accountability Office (GAO). "Older Americans: Inability to Repay Student Loans May Affect Financial Security for a Small Percentage of Retirees." Testimony before the U.S. Senate Special Committee on Aging. Delivered September 10, 2014. <http://www.gao.gov/assets/670/665709.pdf>.

¹⁰ For example, U.S. Department of Education. 2015. *Student Loans Overview: Fiscal Year 2016 Budget Proposal*. <http://www2.ed.gov/about/overview/budget/budget16/justifications/r-sloverview.pdf>; and Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://1.usa.gov/1AU7U2t>.

¹¹ U.S. Department of Education. 2015. *Student Loans Overview: Fiscal Year 2016 Budget Proposal*. <http://www2.ed.gov/about/overview/budget/budget16/justifications/r-sloverview.pdf>.



A less abrupt and more equitable way to target the benefits of PAYE is to gradually phase out the income exclusion for high-income borrowers, remove the standard payment cap, and set all monthly payments at 10% of income, as we propose above. *These changes would better target the forgiveness available after 20 years by factoring in borrowers' income as well as how much they owe*, so higher income borrowers will be more likely to pay off all or most of their debt within 20 years.

If the PAYE maximum repayment period is extended for borrowers with debts above a certain level, the threshold should be based on the *principal amount borrowed*, not on the amount owed when the borrower enters repayment or enters PAYE. It is relatively easy for borrowers to track how much loan principal they are taking on as they borrow, but it can be difficult to track or limit how much they end up owing. The amount owed when borrowers enter repayment is affected by many factors, including the interest rates on their loans, the type of loans they borrowed and when interest begins to accrue for each one, how long the student is enrolled at least half-time, and even potentially the length of their program. For example, under current interest rate projections, an independent undergraduate who borrowed \$52,400 over five years would have a \$57,500 balance when entering repayment.¹² If undergraduate Stafford loan interest rates hit the statutory cap of 8.25%, this same student would only need to borrow \$49,900 over five years to have a \$57,500 balance when entering repayment.

Remove interest capitalization within PAYE

(supported by California State Students Association, Consumers Union, Direct Loan Coalition, US PIRG)

Currently, interest capitalizes when a borrower enrolled in PAYE no longer has a partial financial hardship (PFH) and when he or she chooses to exit PAYE to enroll in another repayment plan. Borrowers no longer have a PFH when 10% of their discretionary income becomes greater than or equal to the 10-year standard payment amount due to changes in their

¹² Calculations assume that the student starts school in 2015-16, graduates in five years, and takes out the annual maximum in subsidized loans and unsubsidized Stafford loans until his last year of borrowing when he borrows less than the maximum. Current interest rate projections are calculated using the Congressional Budget Office's (CBO) January 2015 projections for 10-year Treasury Note yields, <http://1.usa.gov/1vdRSyu>. Figures are rounded to the nearest \$50.

income and/or family size, and when borrowers fail to submit their annual income documentation on time.

We recommend eliminating the capitalization of interest while a borrower remains in PAYE for the following reasons:

- The elimination of the standard payment cap in our targeting proposal means that PFH is no longer a relevant benchmark. Since borrowers' monthly payments will always be based on income, there is no need to capitalize interest when their debt-to-income ratio falls below a particular threshold.
- Capitalizing interest when borrowers lose their PFH status and stay in PAYE may increase costs for borrowers whose incomes are low for extended periods of time, as well as inflate the size of any discharged amount at the end of the repayment period. This is because borrowers with low incomes relative to their debt are more likely to have monthly payment amounts that do not cover accrued interest.
- Removing interest capitalization within PAYE simplifies implementation of the program because loan servicers would no longer need to treat interest differently under specific scenarios or implement the current 10% interest capitalization cap in PAYE, because no interest would capitalize at all within the plan.

If interest capitalization is not eliminated for borrowers in PAYE, it is important to retain the existing limit on the amount of accrued interest that can capitalize. Capitalized interest is added to the borrower's outstanding principal balance, meaning that new interest begins accruing on a higher loan balance and the total amount owed will grow faster than it would have without the capitalization. Currently, the amount of accrued interest that can capitalize in PAYE is capped at 10% of the borrower's loan balance when he or she entered the plan. For borrowers who experience many years of low income while enrolled in PAYE, this protection helps prevent them from having to pay more, and from having a larger balance forgiven, if their income ever rises to the point that they no longer have a PFH and their accrued interest capitalizes. Additionally, under current statute, discharged amounts in PAYE (and the other income-driven repayment plans) are treated as taxable income, so there may also be significant tax implications for some borrowers if the interest capitalization cap is removed from PAYE.

Allow borrowers who consolidate to retain time earned toward forgiveness

(supported by California State Students Association, Consumers Union, National Consumer Law Center, Project on Predatory Student Lending, and 14 other organizations¹³)

After borrowers make 20 or 25 years of qualifying payments in PAYE or IBR (the applicable period depends on which program and when the borrower first took out loans), or 10 years of payments that qualify for Public Service Loan Forgiveness (PSLF), any outstanding loan balance and accrued interest are discharged. However, under current regulations, qualifying payments are not counted toward forgiveness in any of these programs if the loans are later consolidated. This can and should be changed through regulations for PAYE and IBR, as well as for PSLF.

Borrowers who consolidate their loans should get the appropriate credit for what may be years of qualifying payments. For example, consider a student with undergraduate Stafford loans who

¹³ See public comments from organizations representing students, teachers, consumers, and civil rights on proposed rules to improve income-driven repayment plans, submitted on August 16, 2012: http://www.ticas.org/files/pub/Coalition_letter_on_NPRM_8-16-12.pdf.

makes 10 years' worth of payments under PAYE. She decides to go back to school for a master's degree to expand her job opportunities and takes out graduate Stafford loans. After completing her master's degree, she consolidates her graduate loans with her undergraduate loans. Under current rules, she would have to make an additional 20 years of payments on her undergraduate loans before being eligible for a discharge of any remaining debt on those loans under PAYE (if she has not already paid them off), even though she has already made 10 years of payments on those loans – turning what should be a 20-year repayment period into 30 years. Instead, loans that borrowers were repaying before consolidation should be tracked separately from loans just entering repayment, so that borrowers don't lose credit for the payments they've already made.

There are multiple precedents for tracking payments made on loans before consolidation. For example, the Department and FFEL lenders already track pre-consolidation payments on subsidized loans in order to provide a three-year period of interest subsidy on negatively amortized loans in PAYE and IBR.¹⁴ Additionally, for discharges of consolidation loans due to a closed school, false certification, or unpaid refund, only the amount of the underlying loans that was used to pay for the affected program of study are considered for discharge.¹⁵

Treat married borrowers more consistently, regardless of how they file federal taxes

Currently, married borrowers may get lower monthly payments under PAYE if they file their taxes separately than if they file jointly. Married borrowers who file their federal taxes jointly have their PAYE eligibility and payment amounts based on their combined income and combined federal debt, with their PAYE payment amount divided proportionally based on each spouse's share of the total debt.¹⁶ However, existing regulations allow married borrowers who file taxes separately to *exclude* their spouse's income from PAYE calculations, but still *include* their spouse in their family size (for the calculation of the income exclusion). A married borrower who earns a low income and files separately could have very low or even \$0 monthly payments, even if his spouse is a high earner, with the payment lowered even further by being able to count the spouse in his family size. Proposals from the Obama Administration and New America, and recently introduced bipartisan legislation in the Senate, also seek to address the inconsistent treatment of married borrowers who file taxes separately.¹⁷

To address this inequity, the Department should change the definition of "family size" in PAYE so that married borrowers who file taxes separately cannot count their spouse in their family size.¹⁸ It does not make sense to allow borrowers to exclude their spouse's income from the monthly payment calculation but still include them in their family size. Family size is not defined in statute for either PAYE or IBR, so this regulatory change could be made to both programs.

¹⁴ 34 CFR 685.209(a)(2)(iii), 34 CFR 682.215(b)(4), and 34 CFR 685.221(b)(3).

¹⁵ U.S. Department of Education. *Loan Discharge Application: School Closure*. Expiration date 08/31/2017. <http://1.usa.gov/Zuy9vN>. U.S. Department of Education. *Loan Discharge Application: False Certification (Ability to Benefit)*. Expiration date 08/31/2017. <http://1.usa.gov/1tHDMlj>. U.S. Department of Education. *Loan Discharge Application: Unpaid Refund*. Expiration date 08/31/2017. <http://1.usa.gov/Zuyaj6>.

¹⁶ 34 CFR 685.209(a)(2)(ii)(B)

¹⁷ U.S. Department of Education. 2015. *Student Loans Overview: Fiscal Year 2016 Budget Proposal*. <http://www2.ed.gov/about/overview/budget/budget16/justifications/r-sloverview.pdf>. Repay Act of 2015 (S. 85), introduced January 7, 2015, <http://1.usa.gov/1AU7U2t>. New America. 2012. *Safety Net or Windfall? Examining Changes to Income-Based Repayment for Federal Student Loans*. <http://bit.ly/1FYVHZt>.

¹⁸ 34 CFR 685.209(a)(1)(iv)

We also recommend that the Administration support legislative changes to use the combined income and combined federal debt of married borrowers for PAYE and IBR. This is already how married borrowers are treated if they file federal taxes jointly, and we propose treating married borrowers who file taxes separately the same way. That means for all married borrowers, adjusted gross income (AGI) will include the total of the borrower's and the spouse's incomes. Monthly payments will be based on their combined AGI and total eligible federal debt, with payment amounts divided proportionally between spouses based on each one's share of the total debt. And if only one spouse has eligible loans, he will be responsible for the entire IDR payment, calculated based on their combined income. However, because some married borrowers may file taxes separately because they are not able to access their spouse's income, such as in cases of domestic violence or estrangement, it is vital that borrowers have access to an appeals process for such circumstances. In the absence of a robust appeals process, we recommend only making the above regulatory change to the definition of family size.

Eliminate the “partial financial hardship” (PFH) requirement for enrollment

(supported by California State Student Association, Consumers Union, Young Invincibles)

In addition to eliminating eligibility restrictions based on *when* students borrowed, all Direct Loan borrowers should be permitted to enroll in PAYE if and when they choose, *regardless of their debt-to-income level*. Borrowers who want the assurance of having their loan payments fluctuate with their income could then enroll whenever it makes sense for them, whether it is before they make their first payment, after they have hit a rough patch, or when they are concerned about what the future will bring. This change would greatly simplify PAYE, not only for borrowers but also for program administration and communication, *without* increasing the chance of forgiveness for higher income borrowers.

Currently, borrowers must have a “partial financial hardship” (PFH) to enroll in PAYE. That is, 10% of their discretionary income must be *less* than the amount they would repay under a fixed 10-year repayment plan, based on the greater of their loan amount when they entered repayment or their loan amount when they enrolled in PAYE. Eliminating the PFH enrollment requirement would simplify repayment plan selection by allowing borrowers to choose PAYE without their needing to understand or satisfy a technical debt-to-income calculation, simplify the servicing process by eliminating the need to determine PFH, and simplify communication and outreach efforts by removing the need to explain the PFH requirement.

Additionally, this change would align *enrollment* policy in PAYE with current *participation* policy. Currently, borrowers who no longer have a PFH because of changes in income or family size are not required to exit PAYE. Borrowers should not need a PFH to enter, either.

While some have raised concerns that eliminating the PFH enrollment requirement would increase the likelihood or amount of forgiveness for borrowers in PAYE, this is not necessarily the case. Borrowers without a PFH are no better or worse off in PAYE than in the 10-year fixed repayment plan if their incomes stay effectively the same or rise over time. Moreover, borrowers whose incomes drop unexpectedly are *less likely to have any debt discharged* if they could enter PAYE without a PFH than if they are forced to wait to enroll until they have a PFH. See Appendix B for examples illustrating this, as well as how the targeting changes we propose on pages 2-4 would lead borrowers without a PFH to pay off their loans even faster in PAYE.

Depending on borrowers' individual circumstances and preferences, the repayment plan that is best for them may or may not be PAYE. It is important that borrowers are able to make that choice at any point.¹⁹

Provide equitable interest relief for subsidized Stafford loans in PAYE

A borrower's monthly payment in PAYE may not cover all the interest that accrues on his loans each month (negative amortization). In this situation, the government currently pays any remaining unpaid, accrued interest on subsidized loans during the *first three consecutive years from the date the borrower begins repaying under PAYE*. This benefit applies only to subsidized loans, which are available to borrowers with financial need. However, the arbitrary restriction to the first three years in PAYE means that borrowers who are able to cover their interest early on but struggle later in repayment may not benefit at all.

We recommend amending the regulations for PAYE so that the government will pay any remaining unpaid, accrued interest on subsidized loans for up to three *total* years in PAYE, regardless of when those years fall within the borrower's repayment period. This change will provide equitable relief to all borrowers with low incomes relative to their debt.

¹⁹ For more on why borrowers should be able to enroll in income-driven plans but should not be required to do so, see TICAS. 2014. *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges*. <http://bit.ly/1vcNmQX>.

Appendix A: Better Targeting the Benefits of PAYE

The current design of Pay As You Earn (PAYE) can substantially reduce monthly payment amounts for low- and moderate- income borrowers, helping them stay on top of their payments and avoid default even in an uncertain economy. However, it can also allow some high-debt, high-income borrowers to pay a smaller share of their incomes than other borrowers and receive substantial loan forgiveness when they could have afforded to pay more.

To better target the benefits of PAYE to borrowers who need them most, we propose removing the standard payment cap and gradually phasing out the income exclusion for borrowers with high incomes. Both changes would be based on borrowers' debt relative to their income, unlike other targeting proposals that solely focus on borrowers' debt amounts without factoring in their income and ability to repay.

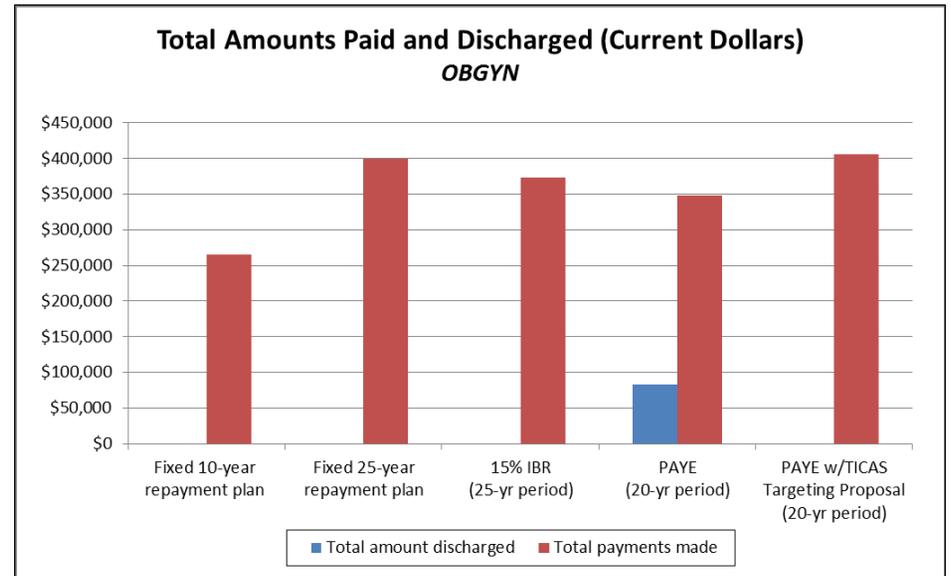
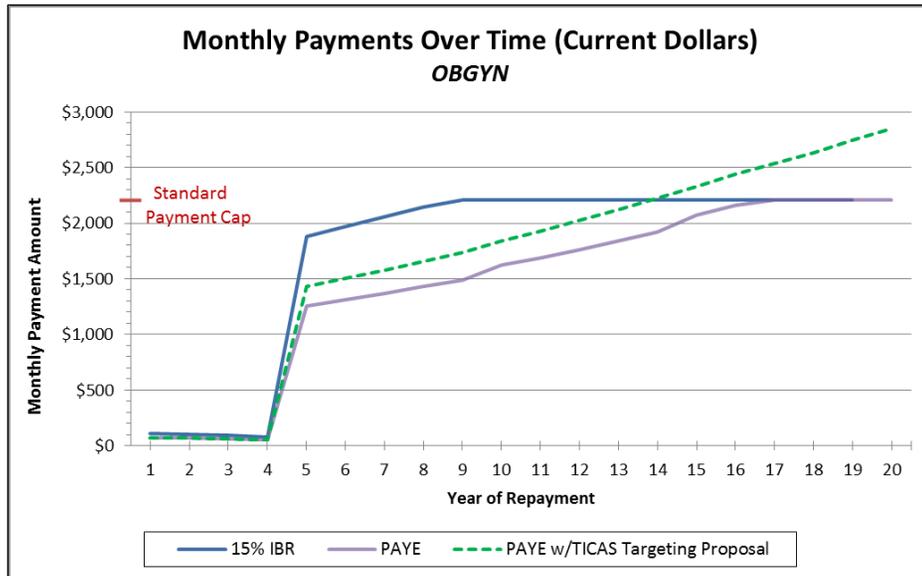
- **Current Policy:** The monthly payment for PAYE is calculated as 10% of the borrower's "discretionary income," up to but not exceeding the 10-year standard payment (also known as the "permanent standard") amount.
 - Discretionary income is defined as the borrower's adjusted gross income (AGI) minus an "income exclusion" of 150% of the poverty level for the borrower's household size and state.
 - The standard payment is the monthly amount the borrower would have had to repay if she had entered a fixed 10-year repayment plan (often referred to as the "standard" plan) with what she owed when she entered PAYE. The standard payment functions as a cap on the monthly payment amount in PAYE.
- **Proposed Changes:**
 - **Remove standard payment cap:**
 - Proposal: Remove the standard payment cap on monthly payments so that borrowers are always making payments based on income.
 - Justification: The way monthly payments are capped in PAYE (and IBR) results in some high-income borrowers paying a smaller share of their income than lower income borrowers. This is because borrowers whose incomes rise above the point where they must start paying the standard payment amount are, by definition, paying a smaller share of their discretionary income than borrowers making income-based payments (i.e., less than 10% of their discretionary income). Removing the standard payment cap better targets benefits by preventing high-debt, high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.
 - **Income exclusion phase-out:**
 - Proposal: Gradually phase out the income exclusion for borrowers with AGIs over \$100,000. The AGI level at which the income exclusion phase-out begins would be indexed to inflation, so it does not decline in real value over time. The income exclusion would remain 150% of poverty up to an AGI of \$100,000. In the following examples, the percentage of poverty used to calculate the income exclusion decreases by one percentage point for each \$1,000 of AGI above \$100,000, until completely phased out at \$250,000 AGI. At an AGI of \$101,000, the income exclusion would be 149% of poverty; at an AGI of \$102,000, the income exclusion would be 148% of poverty; and so forth until it reaches 0% at an AGI of \$250,000. This rate could be adjusted to make the income exclusion phase out more quickly and within a smaller income range (e.g., two percentage points per \$1,000 above \$100,000 AGI, zeroing out at \$175,000 AGI).
 - Justification: Borrowers with high incomes can spend a larger share of total income on loan payments and still have sufficient funds left over to cover basic necessities, such as food and housing.

See examples on the following pages and methodology notes on page 15. For additional recommendations on improving federal student loans, see TICAS' white paper, [Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success](#).

OBGYN: Married with two children, has \$192,000 in loans, earns \$45,000/year during 4-year residency, then \$190,000 when she enters private practice in year 5, increasing 4% a year.

- Without TICAS' proposed targeting changes, she pays less in total under PAYE than under 15% IBR and receives nearly \$83,000 in loan forgiveness.
- With TICAS' proposed targeting changes, she pays more in total under PAYE than in 15% IBR or PAYE and receives no loan forgiveness.

	Fixed 10-year plan	Fixed 25-year plan	15% IBR (25-yr period)	PAYE (20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap
Monthly payment amounts	\$2,210	\$1,330	\$110 to \$2,210	\$70 to \$2,210	\$70 to \$2,850
Total payments made	\$265,150	\$399,800	\$372,850	\$348,050	\$405,900
Total payments, adjusted for inflation	\$235,500	\$300,400	\$286,500	\$257,550	\$299,600
Total amount discharged	n/a	n/a	\$0	\$82,800	\$0
Total amount discharged, in 2015 dollars	n/a	n/a	\$0	\$51,650	\$0
Years in repayment	10.0	25.0	18.3	20.0	20.0



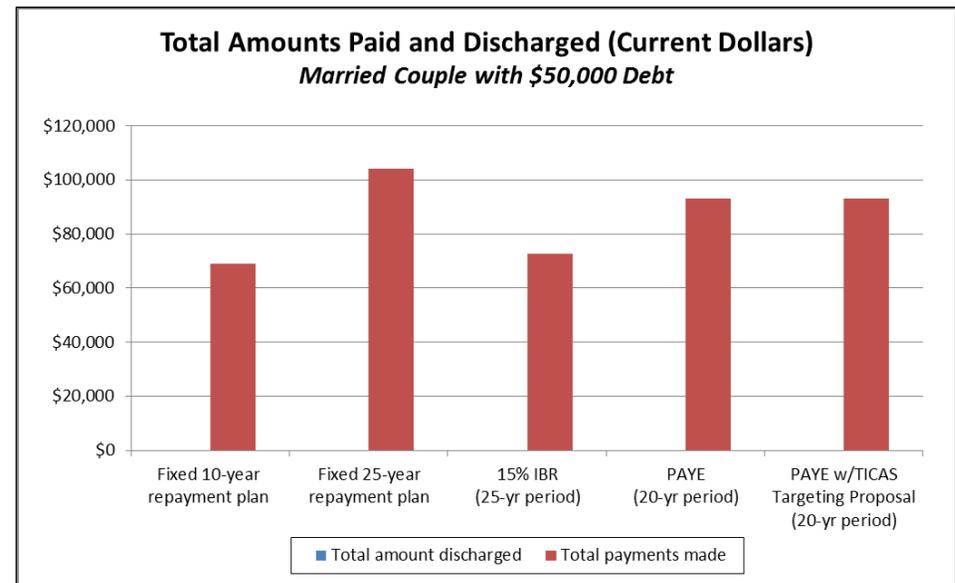
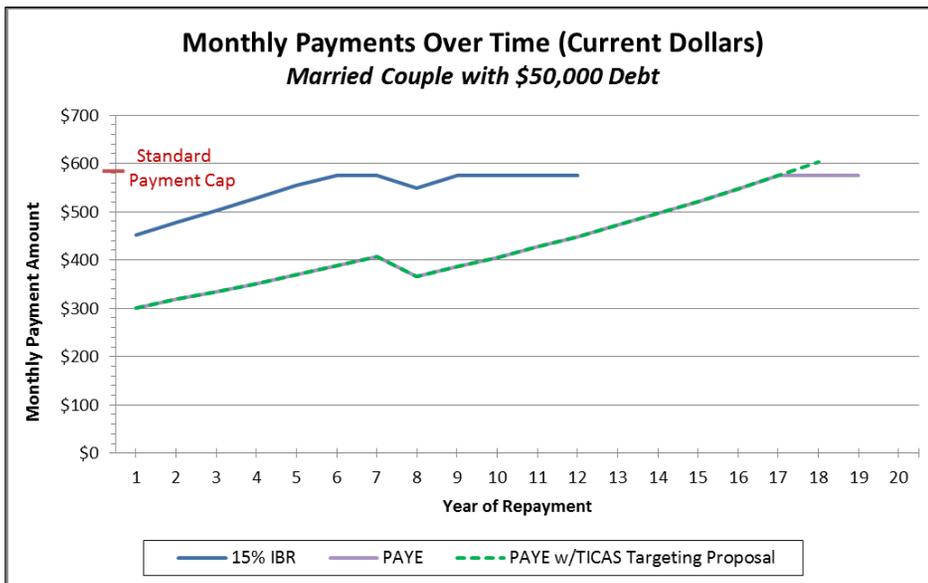
The line graph above displays the monthly payment amount at the beginning of each year. Generally, the borrower pays the same monthly payment amount for the entire year, unless the loan is repaid during that year. The line stops at the year when the borrower pays off his/her loan (if applicable). As her children turn 21 and begin to support themselves, this borrower's household size for PAYE purposes decreases from four in year 1 to three in year 10, then two in year 15.

Note: In 15% IBR (Income-Based Repayment), monthly payments are calculated as 15% of discretionary income and any remaining balance after 25 years of payments is discharged. Borrowers who did not take out loans in the required time period to qualify for PAYE may be eligible for 15% IBR. A version of IBR that is similar to PAYE is available to borrowers who took out their first loan on or after July 1, 2014. For more information about these plans, see studentaid.gov/idr.

Married Couple: Have a child in year 8, \$50,000 in combined loans, earn \$60,000 in first year, income increases 4% a year.

- They repay in full in less than 20 years under all the income-driven repayment plans.
- They pay *more* in total under PAYE and the TICAS proposal than under 15% IBR, but their monthly payments are more manageable.
- Removing the standard payment cap in PAYE would slightly increase their monthly payments at the end of the repayment period, but would not substantially affect the total amount paid or discharged. They would not be affected by the income exclusion phase-out because their income is below the AGI threshold.

	Fixed 10-year plan	Fixed 25-year plan	15% IBR (25-yr period)	PAYE (20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap
Monthly payment amounts	\$580	\$350	\$450 to \$580	\$300 to \$580	\$300 to \$600
Total payments made	\$69,050	\$104,100	\$72,700	\$93,200	\$93,200
Total payments, adjusted for inflation	\$61,350	\$78,250	\$63,350	\$73,700	\$73,700
Total amount discharged	n/a	n/a	\$0	\$0	\$0
Total amount discharged, in 2015 dollars	n/a	n/a	\$0	\$0	\$0
Years in repayment	10.0	25.0	11.3	18.2	18.1



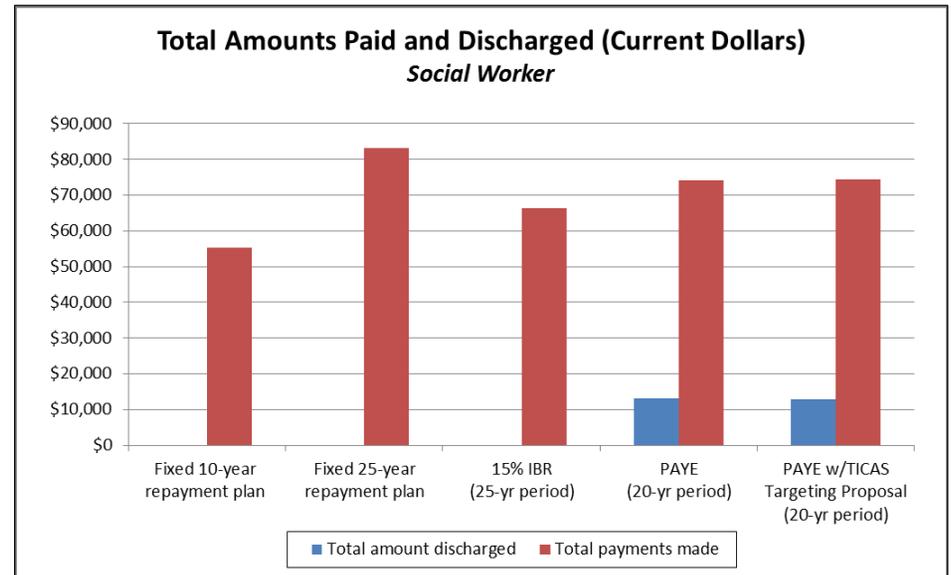
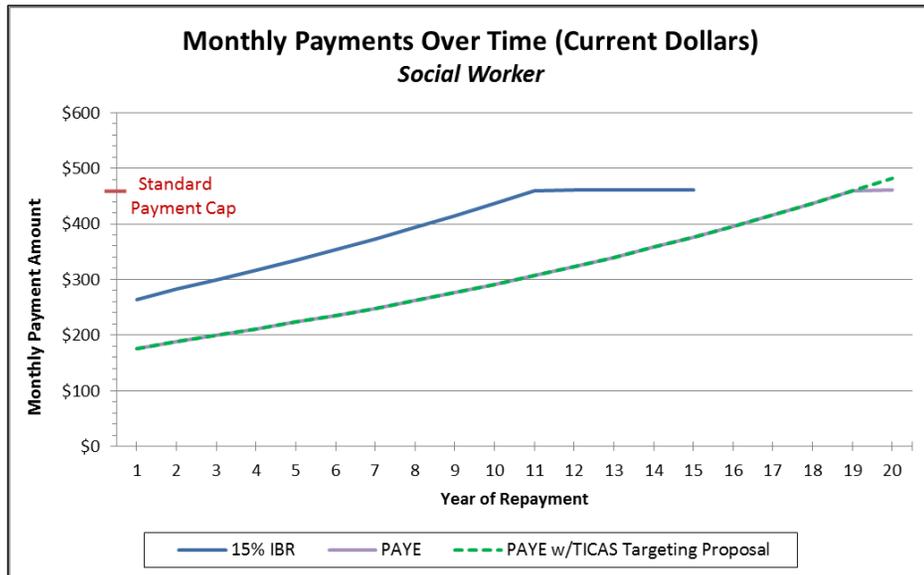
The line graph above displays the monthly payment amount at the beginning of each year. Generally, the borrower pays the same monthly payment amount for the entire year, unless the loan is repaid during that year. The line stops at the year when the borrower pays off his/her loan (if applicable). In PAYE with TICAS' proposed targeting changes, the couple would make one last payment of \$560 (the remainder of their loan balance) at the beginning of year 19 (not depicted in chart).

Note: In 15% IBR (Income-Based Repayment), monthly payments are calculated as 15% of discretionary income and any remaining balance after 25 years of payments is discharged. Borrowers who did not take out loans in the required time period to qualify for PAYE may be eligible for 15% IBR. A version of IBR that is similar to PAYE is available to borrowers who took out their first loan on or after July 1, 2014. For more information about these plans, see studentaid.gov/idr.

Social Worker: Divorced with one child, \$40,000 debt from undergraduate and graduate school, earns \$45,000 as a contractor for a state agency (doesn't qualify for Public Service Loan Forgiveness) when he enters repayment, income increases 4% a year

- He pays *more* in total under PAYE and the TICAS proposal than under 15% IBR, but his monthly payments are more manageable.
- After 20 years of payments in PAYE (with and without TICAS' proposed targeting changes), he repays his entire loan principal plus over \$30,000 of interest, and receives about \$13,000 in forgiveness.
- Removing the standard payment cap in PAYE would slightly increase his monthly payments in the last year of repayment, which has a small effect on his total payments and amount discharged. He would not be affected by the income exclusion phase-out because his income is below the AGI threshold.

	Fixed 10-year plan	Fixed 25-year plan	15% IBR (25-yr period)	PAYE (20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap
Monthly payment amounts	\$460	\$280	\$260 to \$460	\$180 to \$460	\$180 to \$480
Total payments made	\$55,250	\$83,300	\$66,300	\$74,200	\$74,450
Total payments, adjusted for inflation	\$49,050	\$62,600	\$54,950	\$56,550	\$56,700
Total amount discharged	n/a	n/a	\$0	\$13,200	\$12,900
Total amount discharged, in 2015 dollars	n/a	n/a	\$0	\$8,250	\$8,050
Years in repayment	10.0	25.0	14.5	20.0	20.0



The line graph above displays the monthly payment amount at the beginning of each year. Generally, the borrower pays the same monthly payment amount for the entire year, unless the loan is repaid during that year. The line stops at the year when the borrower pays off his/her loan (if applicable). This borrower continues to provide more than half of his daughter's support after she turns 18, so he continues to count her in his family size for PAYE purposes.

Note: In 15% IBR, monthly payments are calculated as 15% of discretionary income and any remaining balance after 25 years of payments is discharged.

Methodology notes:

- Calculations for the TICAS proposal add the income exclusion phase-out and remove the standard payment cap from PAYE. Calculations assume that interest capitalizes if/when the borrower no longer has a partial financial hardship (PFH), consistent with current rules for IBR and PAYE.
- Calculations are based on 2015 poverty levels and assume that the poverty level increases annually at the rate of inflation.
- Calculations assume an average interest rate of 6.8% on all loans.
- Monthly payments are rounded to the nearest \$10, total payments to the nearest \$50.
- Total amounts paid and discharged are illustrated in current dollars and then discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years.

Appendix B: Eliminating the “Partial Financial Hardship” Enrollment Requirement in PAYE

Eliminating the “partial financial hardship” (PFH) requirement to enter PAYE would give all borrowers the choice of having their loan payments fluctuate with their income, without needing to understand or satisfy a technical debt-to-income calculation. This change would greatly simplify PAYE, not only for borrowers but also for program administration and communication, *without* increasing the chance of forgiveness for higher income borrowers. See pages 9-10 for a detailed description of this proposal.

While some have raised concerns that eliminating the PFH enrollment requirement would increase the likelihood or amount of forgiveness for borrowers in PAYE, our analysis shows that this is not necessarily the case. Borrowers without a PFH are no better or worse off in PAYE than in the fixed 10-year repayment plan if their incomes stay effectively the same or rise over time. Moreover, borrowers whose incomes drop unexpectedly are *less likely to have any debt discharged* if they could enter PAYE without a PFH than if they were forced to wait to enroll until they had a PFH.

To understand why, consider two borrowers:²⁰

1. **Amy** does not have a PFH when she enters repayment and continues to have no PFH while in repayment. When she enters repayment, she has \$29,400 in federal debt and earns \$60,000 (adjusted gross income, or AGI). Her income increases 4% a year.
2. **Brian** does not have a PFH until seven years after he enters repayment. Like Amy, he has \$29,400 in federal debt and earns \$60,000 AGI when he enters repayment. However, seven years later, he loses his job and gets a new job at lower pay (\$30,000 AGI).

If Amy were allowed to enroll in PAYE without a PFH, her monthly payments would be the same as in the fixed 10-year plan, and she would repay in full in 10 years. With TICAS’ proposed targeting changes to PAYE, her PAYE payments would be higher than in the fixed 10-year plan and she would repay in full in *less* than 10 years. If Brian were allowed to enroll in PAYE before he has a PFH, he would make larger monthly payments and receive *less* forgiveness than if he has to wait to enroll when he has a PFH in year 7. This is true with or without TICAS’ proposed targeting changes to PAYE. Depending on borrowers’ individual circumstances and preferences, the repayment plan that is best for them may be different. It is important that borrowers are able to make that choice at any point.²¹

This appendix explains why the example borrowers would pay the same or higher monthly payments if the PFH enrollment requirement for PAYE were eliminated. It also shows how the PAYE targeting changes we propose on pages 2-4 and in Appendix A would lead them to pay off their loans even faster in PAYE.

²⁰ See page 20 for methodology notes, including other assumptions about these borrowers.

²¹ For more on why borrowers should be able to enroll in income-driven plans but should not be required to do so, see TICAS. 2014. *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges*. <http://bit.ly/1vcNmQX>.

Amy: Does not have a PFH when she enters repayment and continues to have no PFH

When she enters repayment, she has \$29,400 in federal debt and earns \$60,000 AGI, and her income then increases 4% a year. Under current rules, she is not eligible to enroll in PAYE because she does not have a PFH. She enrolls in the fixed 10-year repayment plan instead, which is currently the default plan for federal loan borrowers.

- If Amy were able to enter PAYE, she would repay her loans in 10 years because she would be making 10-year standard payments while in PAYE. This is because of the current standard payment cap on monthly payments in PAYE, which is marked in red in Figure 1.²²
- With TICAS’ proposed targeting changes to PAYE (green line in Figure 1), she would repay her loans in 7.8 years because her monthly payment (based on income) would be higher than the 10-year standard payment.
- **Regardless of whether TICAS’ proposed targeting changes are made, this borrower would repay within 10 years in PAYE and receive no forgiveness.**

Figure 1: Amy’s Monthly Payments Over Time (she never has a PFH)

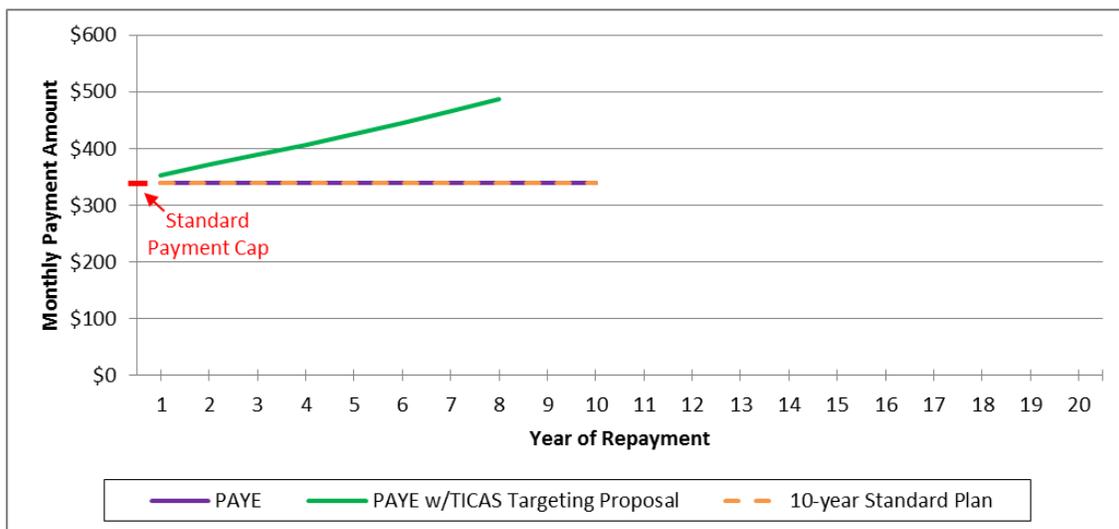


Table 1: Amy (\$29,400 debt, \$60,000 AGI, increasing 4% a year)

	Fixed 10-year plan	PAYE (20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap (20-yr period)
Monthly payment amounts	\$340	\$340	\$350 to \$490
Total payments made	\$40,600	\$40,600	\$38,450
Total payments made, adjusted for inflation	\$36,050	\$36,050	\$34,900
Total amount discharged	\$0	\$0	\$0
Years in repayment	10.0	10.0	7.8

²² Under current rules, the monthly payment for PAYE is calculated as 10% of the borrower’s “discretionary income,” up to but not exceeding the 10-year “standard payment” (also known as the “permanent standard”) amount. The standard payment is what the borrower would have had to pay each month if she had entered a fixed 10-year repayment plan with what she owed when she entered PAYE. The standard payment functions as a cap on the monthly payment amount in PAYE.

Brian: Does not have a PFH in his first year of repayment, but experiences an unexpected drop in income in his 7th year of repayment, creating a PFH

Like Amy, he has \$29,400 in federal debt and earns \$60,000 AGI when he enters repayment. However, he later loses his job and gets a new job at lower pay (\$30,000 AGI). Under the current eligibility rules for PAYE, he would not be able to enter PAYE until he loses his job (year 7), because before then, his income would be too high relative to his debt to meet the PFH enrollment requirement. Until this borrower qualifies to enter PAYE, he repays under the fixed 10-year repayment plan.

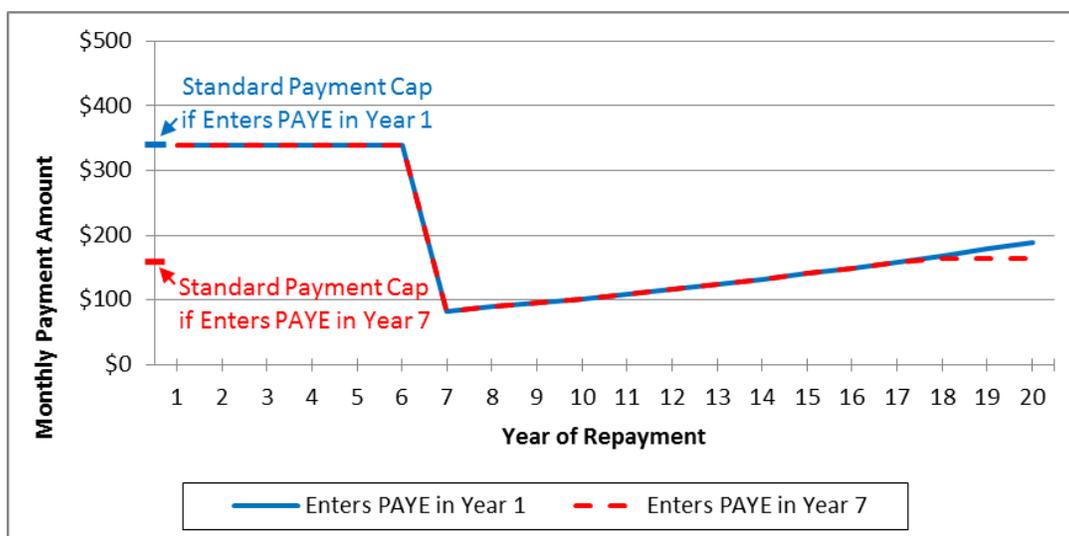
If Brian could enter PAYE in his first year of repayment, he would have the assurance that his monthly payments would be calculated at a lower level if his income falls, without needing to learn about, apply for, and enter a new repayment plan.

Additionally, he is **less likely to have any debt discharged** if he were able to enter PAYE without a PFH than if he were forced to wait to enroll until he has a PFH. This is because he would be making higher monthly PAYE payments if he entered PAYE in the first year of repayment than if he entered PAYE after making 6 years of payments in a fixed 10-year repayment plan. This is true with or without TICAS' proposed targeting changes to PAYE (which include eliminating the standard payment cap), but the targeting changes would affect which years the borrower is making higher monthly payments in PAYE and why those payments would be higher.

Under Current PAYE (with standard payment cap)

Because the standard payment cap is calculated based on the borrower's loan balance *when he enters PAYE*, Brian's maximum monthly payment in PAYE would be *lower* if he repaid in the fixed 10-year payment plan for the first 6 years while he didn't have a PFH, than if he entered PAYE in year 1. The standard payment caps under each scenario are illustrated in the chart below.

Figure 2: Brian's Monthly Payments Over Time (PFH in Year 7) Without TICAS' Proposed PAYE Targeting Changes



- If the borrower had to wait until year 7 to enter PAYE (red dashed line in Figure 2), his maximum monthly payment in PAYE would be \$160, which is the fixed 10-year payment on his loan balance when he enters PAYE in year 7 (\$14,180). This loan balance is lower than the amount he entered repayment with (\$29,400) because he has already made 6 years of payments while in the fixed 10-year plan.

- If the PFH enrollment requirement were eliminated and the borrower were able to enter PAYE in year 1 (blue line), his maximum monthly payment in PAYE would be \$340, which is the 10-year standard payment on his loan balance when he first entered repayment (\$29,400).
- Because his monthly payments in PAYE are capped at a lower level if he enters PAYE in year 7, he makes smaller monthly payments in PAYE and receives 22% more forgiveness than if he were able to enter PAYE in year 1.
- This borrower’s monthly payments in years 1-6 are the same, regardless of when he enters PAYE. This is because the 10-year standard payments he would be making in PAYE (blue line) are the same as the monthly payments he would make under the fixed 10-year plan in the 6 years before entering PAYE (red dashed line).

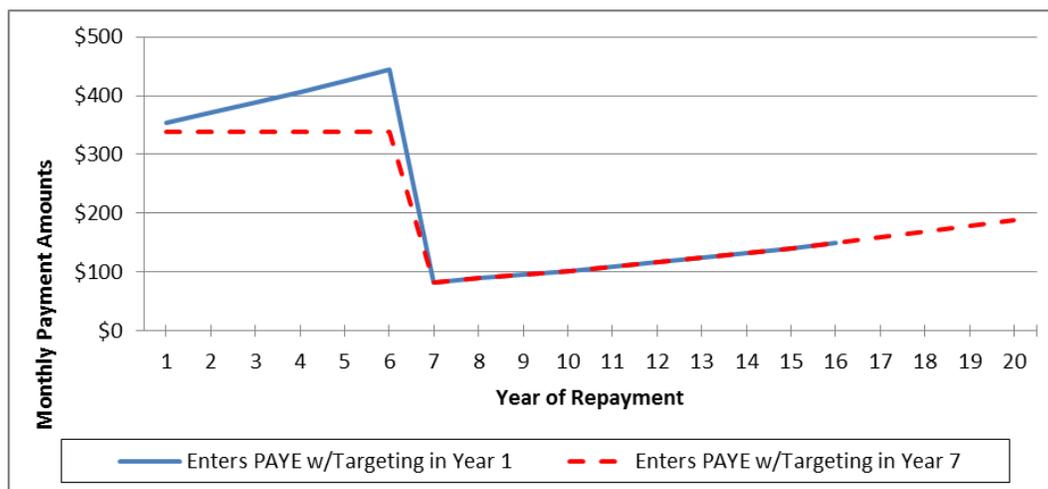
If borrowers cannot enter PAYE until they have a PFH, they will generally make *lower* payments in PAYE than if they could have entered before they had a PFH. This is because payments in all non-income-driven repayment plans cover interest and some principal (no negative amortization).²³ ***Borrowers are more likely to receive forgiveness if they wait to enter PAYE until they have a PFH, because entering PAYE with a smaller balance means their maximum PAYE payment will be smaller as well.***

Under PAYE, with TICAS’ Proposed Targeting Changes (including eliminating the standard payment cap)

Removing the standard payment cap in PAYE means that borrowers would always be making payments based on their income, which may be higher than payments under the fixed 10-year plan.

- As illustrated in Figure 3, the borrower entering PAYE with TICAS’ proposed targeting changes in year 1 (blue line) would be making *higher* monthly payments in years 1-6 than he would under the 10-year standard repayment plan (red dashed line).
- As a result, he would fully pay off his loans in less than 16 years, and receive no forgiveness, if he entered PAYE with TICAS’ proposed targeting changes in year 1.
- If he repaid under the fixed 10-year plan for 6 years before entering PAYE with TICAS’ proposed targeting changes, he would not fully repay his loans within 20 years and his remaining \$2,500 balance would be forgiven.

Figure 3: Brian’s Monthly Payments Over Time (PFH in Year 7) With TICAS’ Proposed PAYE Targeting Changes



²³ This excludes cases where the borrower is not repaying his loans for some reason (e.g., forbearance, delinquency) or if he is repaying under Income-Contingent Repayment (ICR) before he enters PAYE. ICR does not have a PFH requirement and allows for negative amortization. Income-Based Repayment (IBR) also allows for negative amortization but does have a PFH requirement, and a borrower who does not qualify for PAYE based on the PFH requirement would not qualify for IBR.

Table 2: Brian (\$29,400 debt, \$60,000 AGI in year 1, increasing 4% a year, then \$30,000 AGI in year 7, increasing 4% a year)

	PAYE (20-yr period)		PAYE w/TICAS Targeting Proposal (20-yr period)	
	Enters PAYE in Year 1	Enters PAYE in Year 7	Enters PAYE in Year 1	Enters PAYE in Year 7
Monthly payment amounts within IDR (not including payments made in fixed 10-yr plan)	\$80 to \$340	\$80 to \$160	\$80 to \$450	\$80 to \$200
Total payments made	\$46,350	\$45,800	\$41,650	\$46,350
Total payments made, adjusted for inflation	\$38,450	\$38,100	\$36,500	\$38,450
Total amount discharged	\$2,500	\$3,050	\$0	\$2,500
Total amount discharged, in 2015 dollars	\$1,550	\$1,900	\$0	\$1,550
Years in repayment (including time in fixed 10-year plan)	20.0	20.0	15.7	20.0

Methodology Notes:

- Each borrower is single, does not have anyone else in the household, and lives in one of the 48 contiguous states.
- All incomes shown in this appendix are Adjusted Gross Incomes (AGIs).
- Unless otherwise noted, the borrower's adjusted gross income (AGI) increases 4% a year.
- The average interest rate on the borrower's loans is 6.8%.
- Calculations are based on 2015 poverty levels and assume that the poverty level increases annually at the rate of inflation.
- Total amounts paid and discharged are illustrated in current dollars and then discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years.
- Monthly payment amounts displayed in Figures 1, 2, and 3 are in current dollars.
- Monthly payments are rounded to the nearest \$10, total payments to the nearest \$50.