The Earnings Contingent Education Loans (ExCEL) Act

Rep. Tom Petri

Why?

- Simplify and improve student loans for borrowers, encourage responsible borrowing, and save significant taxpayer dollars.

Improving the system for students:

- Instead of mortgage-like repayment, a borrower would pay a percentage of his or her income -- above an allowance for living expenses -- until the loan is repaid.
- Automatically keeps payments affordable, so borrowers pay more when they're doing well and are protected during periods of unemployment or low earnings.
- Interest would not compound during repayment and would be capped at 50 percent of the loan's balance upon graduation.
- Bottom line: Students repay what they borrow, but with affordable payments and protections against the financial ruin that often comes with student loan default.

Don't we have options like this now?

- Yes. Unfortunately, they're very administratively difficult for borrowers to navigate. Because they base payments on past -- not current -- income, borrowers must submit paperwork with evidence of income changes to change payment amounts.
- Layered on top of a student loan system that was already extremely complicated.

These reforms would be easy and intuitive:

- Streamlined payment: Because borrowers pay a percentage of their income, employers would simply withhold an additional percentage along with federal and state taxes.
- No paperwork: Payment amount based on current, not past, income -- so if you lose your job, your payments stop automatically because the withholding stops.
- Simple: Makes obsolete much of the complexity -- the wide array of repayment options, deferments, and forbearances -- in the current system.

How would this save money?

- Reduces defaults and associated collections costs. In the U.K., which has a similar system, 98 percent of borrowers are meeting their obligations. In the U.S., for borrowers entering repayment in 2009, 13.4 percent defaulted within three years.
- Eliminates subsidies made obsolete by these reforms, freeing up money for other priorities such as deficit reduction and Pell Grants.

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Proposal: Combine several federal student loan options (subsidized and unsubsidized Stafford loans, Grad PLUS loans) into a single, simple income-contingent student loan.

This new loan would be similar to Stafford loans except for the following:

- Repaid on a simple income-contingent basis -- payment obligation is a percentage of the borrower's income above 150% of the poverty line each year until the loan is repaid.
  - Because income-contingent repayment automatically responds to a borrower's circumstances, our current complex array of repayment options, deferments and forbearances isn't necessary.
  - Payments are made through withholding, making repayment simple and automatically responsive to the borrower's current circumstances.
  - Borrowers can prepay at any time without penalty.
- This new loan would offer two protections against negative amortization during repayment, instead of forgiveness after 20 or 25 years:
  - Interest during repayment would not compound.
  - Interest would stop accruing when the total amount of interest accrued (paid and unpaid) equals 50 percent of the loan's balance when it entered repayment.
- The interest rate at which the loan is originated would be the 10-Year Treasury rate plus 3 percent for borrowing up to the current Stafford loan limits, and the 10-Year Treasury rate plus 4.1 percent for any amount that a graduate student borrows above the Stafford limits. The rate would be fixed for the life of the loan.

Transition

- New borrowers would be eligible only for this new income-contingent loan. Borrowers with active Stafford or Grad PLUS loans could continue to borrow those types of loans for a limited time.
- The terms of loans that have already been made would remain the same. However, borrowers with existing loans could consolidate into an income-contingent loan.

Loan Limits

- This proposal would not change loan limits. If you would have been eligible to borrow an additional amount under the Grad PLUS program, you can borrow up to that amount for your income-contingent loan, subject to the same credit check and fee requirements that are part of the current Grad PLUS program.
- Parent PLUS and Perkins loans would still available.

Does everyone pay the same percentage regardless of income?

A borrower's obligation is 15 percent of his or her income above the exemption amount. However, because the exemption is a larger share of a low-income individual's income, the effective rate that borrowers pay is below 15 percent and is progressive. For example, for a single individual with no dependents, the exemption amount in 2012 would be $16,755 (150% of the poverty line for a household size of one). The table below shows the effective rate paid by this individual at different salary levels:

Annual wages/salary	Annual Obligation	Effective rate paid
$10,000/yr	$0/yr	0% of gross income
$20,000/yr	$486/yr	2.4% of gross income
$35,000/yr	$2,736/yr	7.8% of gross income
$50,000/yr	$4,986/yr	9.9% of gross income
$80,000/yr	$9,486/yr	11.8% of gross income

Again, these effective rates are for a single person with no dependents. The effective rate paid decreases as you add dependents.

How is my annual repayment obligation determined?

Your repayment obligation is 15% of your income above the exemption amount. The Department of Education would calculate your obligation as follows:

1. Add together the following sources of income on your tax return:
   a. Any salary or wage income.
   b. Any non-salary/wage income (self-employment income, interest, dividend income, capital gains, etc.) above $3,000.
2. If you are married, filing jointly, and you both have loans, divide by two.
3. Subtract the exemption amount.*
4. Multiply by 15%.

**The exemption amount is generally 150% of the poverty line for your household size. However, if you are married, filing jointly, and both spouses have loans, you each get an exemption that is equal to 150% of the poverty line for a household size of one, plus ½ of the additional exemption amount that would come with your dependents.*

What is the annual repayment process?

The following steps outline the annual process of repayment:

1. Payments are withheld by your employer unless your annual salary is less than the exemption amount.

2. On top of amounts withheld, borrowers can make payments towards their annual obligation directly to the Department of Education at any time.

3. File your tax return with the IRS (unless you are exempt from doing so because you didn't earn enough in the year, in which case your obligation will be zero).

4. The Department of Education will send you an annual statement showing whether you met your obligation for the year, owe money, or are entitled to a refund. If you have only minimal amounts (less than $3,000) of non-salary/wage income, payments you've made through paycheck withholding should be sufficient to meet your obligation.

Note: If you anticipate having more than $3,000 in non-salary/wage income, you should either increase the amount being withheld from your paycheck, or you can calculate an additional amount for your loans as part of paying estimated taxes to the IRS. You can also make a payment directly to the Department of Education at any time.

How are payments withheld?

If you are employed, you are required to indicate to your employer that you have loans at the same time you set up your income tax withholding. <u>Your employer does not need to know your loan balance</u>. Your employer will then withhold an additional percentage on top of what is already withheld for income taxes and send the entire sum to the IRS through the same process they use currently.

Note: A borrower who fails to indicate to his or her employer that he or she has a loan could be subject to significant penalties for failing to meet 90 percent of his or her obligation within the year.

What is the IRS's role in the repayment process?

When a tax return is processed that's associated with a loan borrower, the IRS should transfer the data necessary for the Department of Education to determine the borrower's repayment obligation, as well as an account of how much was withheld for the borrower for student loan payments (reported on the borrower's W-2) and how much was paid by the borrower through the estimated tax process (if any). The Department of Education may not use this information for any purpose other than performing the annual reconciliation.

Does this affect private student loans?

No. These reforms are only for federal student loans.

Why use withholding instead of having borrowers make monthly payments?

Making payments through employer withholding is a far simpler way to make payments when your obligation is a percentage of your income, and it has the benefit of automatically keeping your payment amount aligned to our current income. For example, if you lose your job, there is no need to file complicated paperwork and submit documentation that your income has changed. Your payments stop automatically because the withholding stops.

Don't the three other primary countries with systems like this -- New Zealand, Australia, and the U.K., -- have lower tuition and debt levels, so is it fair to compare ourselves to them?

The debt levels in these countries are comparable. In the U.S., in 2011, the average debt of a college graduate who borrowed was around $26,000.[1] Comparing debt levels in other countries:

- In 2009, New Zealand equivalent graduates had a debt of roughly $25,750 NZD ($21,000 USD).[2]
- In the U.K., the average 2011 graduate will leave school with £6480 ($10,497) in Scotland, £17,140 ($27,766) in England, £13,650 ($22,113) in Wales and £15,880 ($25,725) in Northern Ireland.[3]
- The average debt level is slightly lower in Australia at $14,400 AUD ($15,120 USD).[4]

1. http://ticas.org/pub_view.php?idx=865
2. http://news.stv.tv/scotland/106968-scottish-students-have-the-lowest-student-loan-debt-of-all-nations-in-uk/
3. http://www.news.com.au/money/money-matters/forever-in-your-debt-but-students-owe-23bn/story-e6frfmd9-1226426745763
4. http://www.stats.govt.nz/~/media/Statistics/Browse%20for%20stats/StudentLoansandAllowances/HOTP10/StudentLoansandAllowances10HOTP.pdf

Your proposal would eliminate the distinction between subsidized and unsubsidized Stafford loans. Won't this hurt access to higher education for low-income individuals?

Several recent reports compiled by a variety of experts on federal financial aid have advocated for targeting the protections within the student loan system to borrowers who are struggling in repayment -- in lieu of subsidies during school that are based on the student's circumstances before enrollment. In their report, the Rethinking Student Aid Study Group recommended[1] eliminating the distinction between subsidized and unsubsidized Stafford Loans, noting that: *"consistent with the principle that the focus of the subsidy on student loans should be on diminishing the burden of repayment, generous repayment protection will replace the in-school subsidy. There is no evidence that eliminating in-school interest is critical to enrollment decisions."* Other reports[2,3] have also advocated focusing protections within the loan system on borrowers struggling in repayment, freeing up taxpayer dollars for other priorities.

1. http://professionals.collegeboard.com/profdownload/rethinking-stu-aid-fulfilling-commitment-recommendations.pdf
2. http://www.nasfaa.org/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=2766
3. https://dl.dropbox.com/u/52796077/IncROIfromFSA.NCAN.pdf

(more)

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How long would it take to repay these loans?

Some borrowers will pay more quickly if they earn a higher income after school, so they will pay less interest than in the current system while still having affordable payments relative to income. Others will have their repayment stretched out as needed to keep payments affordable, while not paying significantly more in interest as a result of the additional time needed to repay. Each borrower would have a payment plan appropriate to his or her situation.

		Time to Repay (years)[4]		Amount of First Payment and % of Gross Income		Total Payments	
Debt Level[2]	Starting salary[3]	ExCEL	10-Year Standard Amortization[1]	ExCEL	10-Year Standard Amortization	ExCEL	10-Year Standard Amortization
$20,000	$25,000	15	10	$103/mo. (4.9%)	$235/mo. (11.3%)	$30,000	$28,213
$20,000	$35,000	9	10	$228/mo. (7.8%)	$235/mo. (8.1%)	$26,924	$28,213
$20,000	$50,000	5	10	$416/mo. (10%)	$235/mo. (5.6%)	$23,565	$28,213
$20,000	$75,000	3	10	$728/mo. (11.6%)	$235/mo. (3.8%)	$21,990	$28,213
$40,000	$25,000	23	10	$103/mo. (4.9%)	$470/mo. (22.6%)	$60,000	$56,426
$40,000	$35,000	15	10	$228/mo. (7.8%)	$470/mo. (16.1%)	$60,000	$56,426
$40,000	$50,000	10	10	$416/mo. (10%)	$470/mo. (11.3%)	$55,775	$56,426
$40,000	$75,000	6	10	$728/mo. (11.6%)	$470/mo. (7.5%)	$48,275	$56,426
$57,500	$25,000	28	10	$103/mo. (4.9%)	$676/mo. (32.4%)	$86,250	$81,112
$57,500	$35,000	20	10	$228/mo. (7.8%)	$676/mo. (23.2%)	$86,250	$81,112
$57,500	$50,000	13	10	$416/mo. (10%)	$676/mo. (16.2%)	$86,250	$81,112
$57,500	$75,000	8	10	$728/mo. (11.6%)	$676/mo. (10.8%)	$75,467	$81,112
$75,000	$25,000	32	10	$103/mo. (4.9%)	$882/mo. (42.3%)	$112,500	$105,798
$75,000	$35,000	23	10	$228/mo. (7.8%)	$882/mo. (30.2%)	$112,500	$105,798
$75,000	$50,000	16	10	$416/mo. (10%)	$882/mo. (21.2%)	$112,500	$105,798
$75,000	$75,000	11	10	$728/mo. (11.6%)	$882/mo. (14.1%)	$107,584	$105,798

1. The 10-Year Standard Amortization plan is the default plan a borrower would be placed into in the current system. This plan is used for comparison purposes.

2. A dependent undergraduate may borrow up to $31,000 in aggregate. An independent undergraduate may borrow up to $57,500 in aggregate. Graduate students can borrow up to the cost-of-attendance for their institution. **Roughly 95% of borrowers have student loan debt below $75,000 and roughly 88% of borrowers have student loan debt below $50,000.** (http://younginvincible.com/wp-content/uploads/2012/06/PUB_Student_Loan_Borrowers_FINAL.pdf) In 2011, the average college graduate in 2011 (who borrowed funds to pay for school) graduated with roughly $26,000 in debt.

3. Inflation is assumed to be 2.6 percent and the borrower is assumed to have real-income growth of 1.5 percent. Interest is assumed at 6.8%. The borrower is assumed to be single with no dependents -- each dependent added would reduce a borrower's annual payment obligation by roughly $890 ($74 per month).

4. Because the borrower is paying a percentage of his or her income each year, the time to repay is not fixed under ExCEL (it varies depending on the borrower's income path).