CFI in Focus
Insights from Recent Research on Income-Contingent Student Loan Repayment

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Federal student loans are one of the main sources of funds used to pay for college, and they now constitute one of the largest sources of outstanding household debt in the United States. Borrowers owe $1.6 trillion as of 2024, with federal student loans accounting for 92 percent of the outstanding student debt. Over 40 million Americans currently hold student loans, with an average balance of nearly $40,000 per borrower. As loan balances rise — and particularly during difficult economic times — there is increasing worry about student borrowers' ability to make payments. With only 60 percent of students who enroll in postsecondary education ultimately completing their degrees and considering increasingly varied financial returns on investing in a college education, it is not surprising that many borrowers struggle with student loan repayment. Because one in four American adults under 40 have outstanding student loan debt, challenges borrowers face with student loan repayment could even affect broader economic activity.

Policymakers have responded to these concerns by introducing several policies intended to reduce or eliminate monthly payments or outstanding balances. Examples of such policies include the U.S. Department of Education's unprecedented three-and-a-half-year payment pause on federal student loans during the COVID-19 pandemic, and the hundreds of billions of dollars in targeted loan cancelation in recent years. Most relevant to this article is the Saving on a Valuable Education (SAVE) plan, an income-driven repayment (IDR) plan the Department of Education announced in the summer of 2023 as borrowers prepared to exit the COVID-19 payment pause.

The Department of Education's IDR plans are offered in recognition that the "standard" repayment plan for federal student loans — which features equal monthly payments over the typical 10-year loan term — may not necessarily be the best option for all borrowers as loan amounts continue to rise. Some borrowers' earnings fluctuate year to year, or even month to month. And some borrowers cannot secure jobs that pay enough to support payments in the standard plan. IDR plans can offer flexibility in such cases and potentially reduce borrowers'

[1] The views expressed here are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. No statements here should be treated as legal advice.

monthly payments by setting payments to a lower percentage of the borrower's discretionary income (i.e., a lower income share) while requiring no payments from the lowest-income borrowers (i.e., offering a payment waiver). At the same time, many IDR plans tack on some or all unpaid interest to the outstanding balance, and they potentially extend time to repayment while forgiving any remaining balance after a set amount of time. In other words, loan payments under an IDR plan are generally more affordable and manageable for borrowers, but some borrowers may pay more for their loans, may pay for a longer period, or may see their outstanding balances grow because of unpaid interest. Borrowers in the U.S. typically must apply for an IDR plan and recertify their incomes annually to remain eligible. They can also switch back and forth between the standard, fixed-payment plan and one of the available IDR plans, depending on their incomes and other circumstances.

The first IDR plan for federal student loans was launched in 1994. It was not particularly popular with borrowers, as it featured a relatively high income share (20 percent of a borrower's discretionary monthly income, defined as income above 150 percent of the federal poverty line), a relatively low income threshold to be eligible for a payment waiver (150 percent of the poverty line), and a relatively long maximum time to pay off the loan (up to 20 years for undergraduate loans and 25 years for graduate loans). There have been five substantive revisions to IDR plans since then, with a general trend toward more generous terms: lower income shares for calculating monthly payments, higher income thresholds below which no payments are due, and shorter maximum terms before any remaining balance is forgiven. When it was announced, the SAVE IDR plan featured the lowest yet monthly income share (5 percent for undergraduate loans and 10 percent for graduate loans), the highest yet exemption threshold for having no payments due (225 percent of the federal poverty line for the borrower's household size), a shorter maximum term (10 years or less for undergraduate loans and 20 for graduate loans), and no possibility of rising balances.

Meanwhile, over the last decade or so, income share agreements (ISAs) have been on the rise as a form of private student loans, in which students receive funding for college from colleges or private lenders and agree to repay a set share of their future incomes for a fixed amount of time.[2] Unlike a federal student loan with the option of an IDR plan, where borrowers can switch back and forth between IDR and standard plans, payments calculated as a set share of income are the default and only option in an ISA. In other words, borrowers with ISAs always make payments as a

[2] For a detailed discussion of the features and design of ISAs, see Ritter and Webber (2019).

share of income, are not required to make payments if earning below a defined income threshold, and are expected to make a set number of payments before satisfying the loan obligation. On the other hand, the maximum total dollar amount of payments is typically higher for ISAs than for traditional student loans. The income shares, minimum income thresholds, and maximum repayment terms vary widely with the type of lender, educational program, and sometimes the field of study. Private lenders and colleges have generally focused their ISA offerings on borrowers and educational programs that are not eligible for federal IDR plans, such as parent borrowers, noncitizen borrowers, and borrowers pursuing certain short-term credentials. For those reasons and others, ISAs offered by private lenders have remained a niche market in the United States compared with traditional private loans, but several countries' government loan programs exhibit ISA-like features.

Recent research by the Consumer Finance Institute (CFI) has examined the challenges borrowers face at various stages of borrowing and repaying student loans — from the complex factors influencing the decision to take out student loans, to the choice of repayment plan after leaving college. This research is particularly important in light of several recent lawsuits delaying or blocking key provisions of the SAVE IDR plan, which may call for different policy solutions to address unaffordable student loan burdens. These legal challenges may limit the usefulness of the SAVE plan and increase the urgency of assessing alternative solutions to ensure that higher education remains financially accessible and sustainable. In this *CFI in Focus*, we summarize insights from three recent studies published by CFI researchers on the topic of income-contingent student loans. [3]

Understanding Preferences over Different Income Contingencies

In a recent working paper, CFI's Dubravka Ritter and coauthors analyzed the results of an experiment designed to understand college students' preferences for income-contingent student loan repayment plans. The large, nonprofit partner university offered students in its survey a choice: either a hypothetical 10-year federal student loan with an IDR plan (modeled after the IDR plan offered at the time of the survey), or a hypothetical 10-year ISA (modeled after the ISA the university was considering facilitating for its students through a partner lender). The 2,776 anonymous junior

[3] Throughout, we refer to loans that tie payments to income as "*income-contingent student loans*." Both IDR plans and ISAs are a forms of income-contingent student loans with different features and implementation.

and senior students in the study were randomized into two groups, with one group (the control group) receiving a basic description of each loan's features and the other group (the treatment group) receiving more details of each product, including its income contingency features. For example, the more detailed description clarified that the federal loan requires borrowers to apply and annually recertify their incomes to remain eligible for the IDR plan, as well as that the loan term may be extended up to 20 years. For the ISA, the more detailed description clarified that payments automatically rise and fall with income for the duration of the loan, and that the term may extend up to 13 years if borrowers skip payments because of periods of payment waivers.

Comparing the responses by the two groups showed that providing more details on and emphasizing the income contingency of the two products increased the preference for the hypothetical ISA by 43 percent (or 10 percentage points). Whether students saw details of the income contingency and maximum loan term was the single strongest predictor for ISA preference. The results showed that delving into the nuances of financial contracts — such as the ways payments would be affected by employment and financial circumstances — can significantly affect preferences. The only group that was not particularly responsive to the detailed language was students who had taken out federal student loans in the past, suggesting that previous familiarity with financial products may also influence preferences.

In a follow-up, the authors examined student preferences by offering alternative hypothetical ISAs with longer/shorter loan terms and lower/higher income shares. They also asked whether students would change their responses if there was a 50 percent chance that the federal student loan would be canceled. Overall, students were quite responsive to changes in features of the ISA and the possibility of loan cancelation. Specifically, many students who originally chose the federal student loan changed their preference to the hypothetical ISA with a lower income share and a longer maximum term. In contrast, many students who originally chose the ISA and were exposed to the detailed language switched to a shorter-term ISA with larger monthly payments.

Conventional wisdom suggests that borrowers disliked long maximum terms and growing balances in previous IDR plans; this was one of the justifications for lowering the maximum term in the SAVE plan, for example. Our results cast some doubt on this proposition, as we find that even borrowers with federal loans may prefer an ISA-like loan so long as it features lower payments stretched out over a longer time horizon. That said, all students were more likely to switch back to the government student loan when the possibility of forgiveness for the government loan was

introduced, illustrating that any private loan solution is likely to face an uphill climb against a government loan with such features.

Interestingly, government student loan programs in countries like Australia and the United Kingdom look more like a low-share, long-term, government-sponsored ISA-like loan than like the U.S. Department of Education's IDR plans. In those countries, all borrowers with government loans make payments as a share of income over a maximum of 20–25 years, with income shares that often rise with income (beginning at 1 percent for the lowest-income borrowers and up to 10 percent for the highest-income borrowers in Australia, for example). In fact, the United States is one of the few developed countries where an IDR plan is an option that borrowers can enter and exit depending on their circumstances, with a strong focus on paying off loans as soon as possible. What is more, the relevant regulatory agency in the United Kingdom recently *extended* the maximum time to repayment as opposed to shortening it.

The results from this study have important implications for how student loan repayment plans might be designed, offering novel insights into the preferences of prospective student borrowers over different loan features. Students' stated preferences depend on the presentation of contract terms and underscore how important messaging is for lenders, servicers, and the Department of Education. These findings will be particularly useful if key provisions of the SAVE IDR plan remain blocked by courts, requiring renewed attention to the design of federal student loan programs and to viable potential options offered by private market participants.

Survey Insights on Borrower Awareness and Take-Up of New SAVE Plan

In the fall of 2023, CFI collected novel survey data to study federal student loan borrowers' experience with the student loan payments resumption. CFI's Tomás Monarrez and Dubravka Ritter published the findings in a four-report series in early 2024. These survey data, collected from more than 2,000 student loan borrowers in November 2023, gathered high-level information about borrowers' repayment status, as well as current and previous enrollment in IDR plans. The third report in this series took the pulse of federal student loan borrowers' awareness of and enrollment in the SAVE IDR plan, as well as the prospect for this relief option to reduce payments for borrowers not already enrolled in the plan.

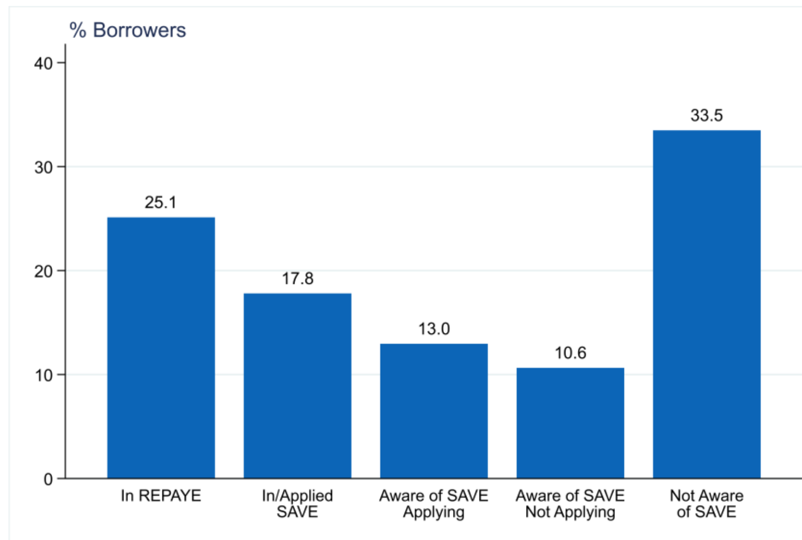
This report found that many borrowers remained unaware of the SAVE plan as of November 2023 — despite continued outreach by the Department of Education and loan servicers. One-third

of federal student loan borrowers in repayment reported being unaware of the SAVE plan months after it was made available (**Figure 1a**). Borrower groups with the lowest awareness of SAVE included borrowers with incomes below $40,000 per year, borrowers older than 55, female borrowers, and borrowers with some college education but no degree.

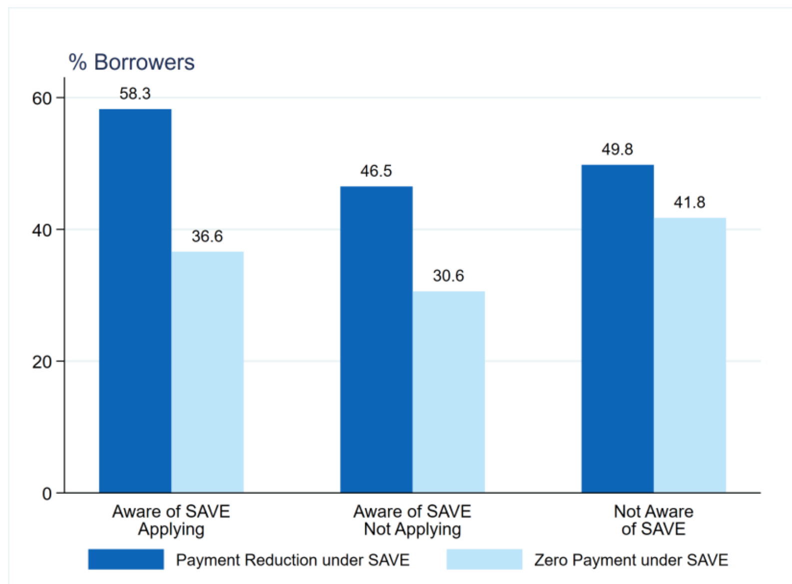
After the initial awareness check, the authors sought to understand borrowers' plans to enroll in the SAVE IDR plan, presenting more detailed eligibility criteria and features of the SAVE plan to survey respondents. Nationwide, over 2 million borrowers (or about one in eight borrowers with federal loans) had newly enrolled in SAVE by November 2023, and CFI data echoed those patterns. Among survey respondents who did not intend to enroll in SAVE, borrowers often had valid reasons. Some were not eligible because of the type of loans they held, while others did not want to potentially extend their repayment term. However, there was a substantial share of likely eligible respondents who would have likely seen their monthly payments reduced by SAVE but who had not enrolled in the program as of November 2023 (**Figure 1b**). Nearly one-half of prospective enrollees — eligible borrowers with federal student loans in repayment who were not already in the SAVE plan — might see a reduction in their scheduled monthly payment relative to their current scheduled payment, were they to enroll in the SAVE plan. More than one-third of prospective enrollees likely would not have to make payments on their loans at all because their incomes were below the discretionary income threshold determined by the Department of Education.

Figure 1. Awareness of and Estimated Payment Reductions Under SAVE

(a) Awareness of the SAVE Plan



(b) Estimated Payment Reduction Under SAVE



Source: Federal Reserve Bank of Philadelphia Consumer Finance Institute Survey Data, November 2023. Originally published as Figure 1B and Figure 5 in Monarrez and Ritter (2024).

Notes: Sample includes all respondents with federal student loans in repayment in Figure 1A. In Figure 1B, the sample is all borrowers with federal student loans in repayment who were not already enrolled in the SAVE plan and who did not report being ineligible because of having predominantly parent loans or private loans

The analysis in this report provided evidence that awareness of this new repayment plan was still incomplete by November 2023, with nearly one-third of borrowers who were not already

enrolled in the plan reporting being unaware of the SAVE IDR plan. Awareness was the lowest among financially vulnerable populations with a relatively higher risk of struggling with loan repayment, as found in CFI's previous reports, such that continued outreach by the Department of Education and servicers appears to have been warranted. In other words, as of the end of 2023, the SAVE IDR plan remained an untapped relief option for many borrowers who may have needed it.

Evidence on Persistence and Delinquency in IDR Plans

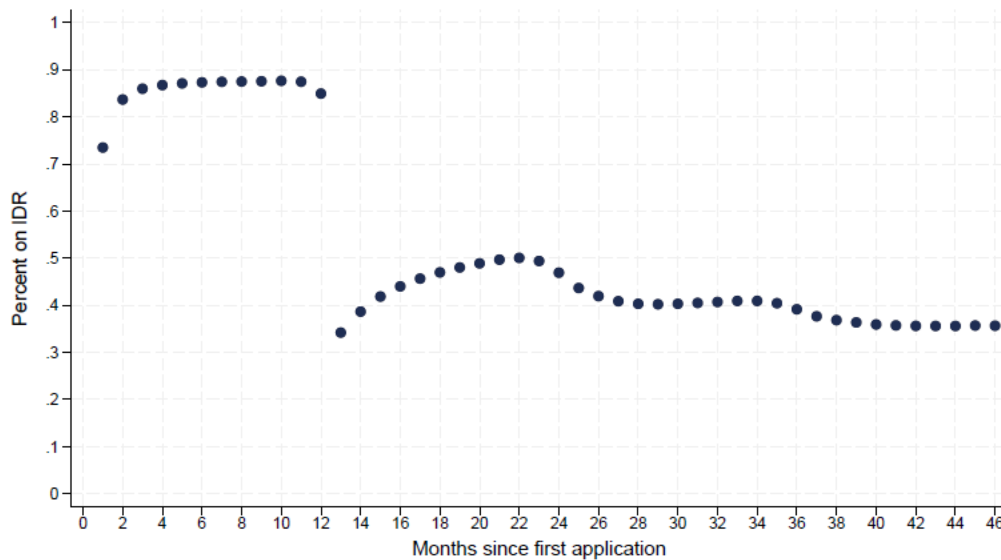
CFI's research has also investigated the effects of administrative and behavioral hurdles that may impede borrowers from remaining enrolled in IDR plans. To receive the full set of benefits from IDR, participants typically must remain in the program for several years. Until recently, an annual recertification of income was necessary to do so, involving a lengthy application and documentation process, and many borrowers did not recertify eligibility for IDR. Even so, most estimates of IDR plans' cost to taxpayers assume that borrowers stay on an IDR plan once they enter it (unless their income grows rapidly).

In a recent working paper, CFI's Tomás Monarrez and visiting scholar Lesley Turner investigated IDR participants' persistence in the program after the year they first applied. Using unique anonymized administrative records drawn from the Department of Education's Federal Student Aid system, the authors found that, over 2015–2018, about 50 percent of first-time IDR applicants completely dropped out from the plan within one year after entry (**Figure 2**), indicating that IDR recertification rates were much lower than researchers or policymakers previously thought. In theory, low recertification rates could be driven by different factors. On the one hand, borrowers might be "back on their feet" in terms of employment/income and not require the assistance of an IDR plan any longer; on the other hand, they could be forgetting to recertify their incomes to maintain eligibility, even though they might still stand to benefit from IDR protections. The results of the study established that low recertification rates are most likely driven by borrower inattention, not increases in income. This inattention is costly, as borrowers falling out of the IDR program saw subsequent increases in delinquency rates.

To establish these findings, the authors studied a subset of borrowers who qualified for a payment waiver because they had incomes below 150 percent of the poverty line. By comparing the outcomes of borrowers whose incomes were just below and just above the payment waiver cutoff, the authors could isolate the effect of not having a payment due on participants' financial health

and repayment outcomes. They found that many of those who would stand to see the largest payment reductions from an IDR plan failed to take advantage of the plan's features over the long term by failing to provide the annual income recertification. The pattern of results suggests that the payment waiver likely causes borrowers to become "disconnected" from the loan program, with negative consequences for their repayment outcomes in the future, including increased delinquency and higher scheduled monthly payments. Importantly, this research focused on a set of IDR plans that were available to borrowers before the introduction of the new SAVE plan. The SAVE plan attempted to alleviate some of the concerns with the burden of reapplication by using Internal Revenue Service (IRS) income data to automatically recertify borrowers' income for up to five years. That said, administrative hurdles have not been fully alleviated by SAVE, as borrowers must opt in for IRS data sharing and must be in contact with their servicer or the Department of Education to enroll in an IDR plan in the first place. Should the Department of Education, Congress, or private lenders seek to redesign IDR plans in the future, this research can inform potential features that can minimize disconnection and their potential negative effects on borrowers' financial well-being.

Figure 2: Share of First-Time IDR Applicants Remaining in IDR



Source: Originally published as Figure 1A. in Monarrez and Turner (2024) using U.S. Department of Education administrative student loan records.

Notes: The sample includes first-time IDR applicants in 2015 through 2018.

In sum, CFI's research on IDR plans has shed light on some of the most important policy questions on federal student loan repayment. The three featured studies illustrate the potential for income-contingent student loans to alleviate the financial stress of unemployment and income variability for student loan borrowers, while also highlighting the design and implementation challenges these repayment plans face. As policymakers and lenders seek to make higher education more accessible and financially sustainable, income-contingent financing will remain an essential area for future inquiry. But ongoing research, thoughtful policy design, and effective borrower outreach will be crucial to ensure that income-contingent repayment delivers effective benefits to borrowers while grappling with challenges around borrower preferences, product sustainability, and costs to taxpayers. The ongoing legal challenges to the SAVE IDR plan only highlight the fragility of many policy solutions in this area and the importance of continued research.

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