Making Informed Choices About Loan Repayment

Helping students navigate repayment plans

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At Valencia College in Florida we redesigned and then tested an important form – and found that as a result, students were better able to remember plan information and take it into account.

Student loans enable millions of Americans to access postsecondary education every year, but paying back those loans can cause financial hardship. According to the Department of Education (ED), about one in eight borrowers who took out student loans in 2012 have already defaulted on those loans. This can have devastating long-term impact on borrowers' access to credit in the future.

In theory, the ability to choose among different loan repayment plans (with varying monthly payment amounts and other terms) should help student borrowers avoid default by putting them in a better position to make payments in the first place. There are many obstacles, however, that make it difficult for borrowers to choose the right repayment plan for them.

Currently, borrowers are automatically enrolled into the Standard Repayment Plan and must wait until the end of the grace period before they can switch to another plan, at which point they may forget to do so. Even if borrowers do remember to review their plan and determine that they want to switch, they may procrastinate on switching because of significant hassles (e.g., contacting their loan servicer). Moreover, informational resources designed to help borrowers compare the various plans and their differences require significant time and mental energy to understand. In the end, borrowers are likely to suffer one of two outcomes: either they fail to switch to a plan that better suits their financial needs altogether, or they switch plans only after they fall behind on payments.

Highlights

- 1 in 8 borrowers of student loans in 2012 have already defaulted on their loans
- Improving presentation of critical information can make it more salient for the student to understand which choices to make
- Prompting borrowers to actively choose a repayment plan early could help get them on the right plan for them and reduce default

Given the difficulty involved in choosing a repayment plan, ideas42 sought to determine whether improving the presentation of plan information—using ED's online table as a starting point—could help borrowers better understand the plans and choose between them. We redesigned the ED table to provide concise plan descriptions, highlight select plan attributes, and facilitate comparing plans. To test the effectiveness of the redesigned table, students at Valencia College were randomly assigned to see either the redesigned table or the original ED table before selecting a plan for a hypothetical loan.

Students who saw the redesigned table better remembered plan information and reported taking it into account more often than students who saw the ED table. However, rather than select more diverse plans to suit their repayment needs, all students selected the Standard Plan at the same rate. Similarly, in a follow-up online study (with non-student participants) to assess the impact of naming a plan 'Standard,' we found no evidence that simply removing the 'Standard' label or applying it to different plans influenced participants' choices.

Notably, the rate at which participants in both studies preferred the Standard Plan is lower than the rate of actual loan borrowers entering repayment with it. Rather, the rate of Standard Plan-enrolled students in the study more closely matches the rate of borrowers enrolled in the Standard Plan several years into repayment. This finding suggests that prompting borrowers to choose a plan earlier – regardless of how the information is presented or the plans are named – could get them closer to selecting the right plan for themselves.

Overall, we find that improving the presentation of repayment plan information can help borrowers better understand and take into account plan information, but influencing actual selection would require making substantive changes to the borrower engagement process itself. Further tests will focus on improving the timing of borrowers' plan selection by facilitating an active choice for them when they enter repayment.

Making the right choices

At the conclusion of the six-month grace period following graduation (or withdrawal from their program of study), students automatically begin repayment under the Standard Repayment Plan—the plan with the lowest amount of interest paid over time but the highest initial monthly payment amount. By switching from the Standard Plan to another type of plan, borrowers can reduce their monthly payment amount and extend their loan's repayment term (for example, through the Extended Plan), or pay according to their income amount through an income-driven plan (for example, the Pay As You Earn Plan). The flexibility provided by these options can help borrowers avoid missing payments and slipping into default, though borrowers may ultimately pay more in total over the life of the loan.

Highlights

- Data from Valencia college students shows standard repayment plan may not actually suit many borrowers
- Nearly 1/3 of delinquincies happen within 60 days

Data from Valencia College suggests that the Standard Plan might not actually suit many borrowers' financial needs and preferences. The share of borrowers repaying under the Standard Repayment Plan is highest upon entering repayment and gradually decreases for several months thereafter. For Valencia College borrowers, nearly a third of delinquencies occur within 60 days of entering repayment, the period with the highest share of loans under the Standard Plan, and loans under this plan are three times more likely to become delinquent. It appears that the combination of beginning to repay loans under the highest monthly payment amount—the default option—could be an important factor in missing payments, and is an outcome that could be prevented by having lower payment amounts. More broadly, the available data from Valencia College suggest that borrowers may not be actively considering and selecting repayment options to match their financial needs at the moment of entering repayment.

A jumble of information

Several behavioral factors may prevent borrowers from choosing suitable repayment plans. First, many borrowers are likely to stick, knowingly or not, with the Standard Plan into which they are automatically enrolled. Only those who miss payments and are contacted by their servicer—or those who proactively seek to take control over their repayment situation—will have an opportunity to choose a different plan. Even those who learn about different plans while at school (such as during exit counseling) will have to wait several months until their grace period is over to do so, by which time they may have forgotten to take action. For borrowers who do remember to proactively change their plan, the hassles of choosing—requesting forms, evaluating different options, and filling out and sending back the forms—mean that many will give up, defer making a selection, or select a plan they did not intend to.

Highlights

- Many borrowers are likely to stick with the plan they are automatically enrolled in
- Borrowers have to wait until end of grace period to change repayment plans, by which time they may forget to do so

When it comes to selecting a plan, the authoritative resource for student aid information is ED's Federal Student Aid website, which contains a table describing repayment plans. However, much of the information can be complex and hard to interpret, as seen in the monthly payment description for the Income-Based Repayment Plan: "15 percent of discretionary income, the difference between your adjusted gross income and 150 percent of the poverty guideline for your family size and state of residence (other conditions apply)." Throughout the table, technical terms like discretionary income and partial financial hardship likely require flipping back and forth to a separate glossary, adding hassles to already complicated material. Furthermore, the table lacks figures that would make comparisons across key aspects of the plans possible. Looking for a reference point amid this jumble, borrowers may read unintended meanings into the names of the plans themselves—they may, for instance, take the name "Standard Plan" as an implicit recommendation.

Designing and Testing a new form

To determine whether a behavioral approach to presenting repayment information could help borrowers better understand and consider relevant information when selecting a plan, we randomly assigned nearly 400 students—almost half of them with student loans—to view either the redesigned table or ED's table, and compared the ways in which the two groups selected plans.

The redesigned table simplified attributes for each plan: the monthly payment amount, the length of repayment and the total interest to be paid. Numbers based on a provided loan scenario replaced blocks of words to facilitate comparison between plans. The table also renamed and reordered the plans to avoid the influence of factors that may be salient for arbitrary reasons, such as plan name.

Highlights

- Prompting students to choose a plan may get them closer to their ultimate plan choice
- Redesigned table increased consider-ation and memory of important repayment plan attributes

Overall, more students who saw the redesigned table reported that they considered important plan attributes, such as the total interest to be paid (80% vs. 66%-67%)[1] and the repayment term (78% vs. 71%),[2] than students who saw the ED table. Similarly, fewer students reported taking into account the name of the plan (8% vs. 17%),[3] demonstrating the salience and influence of plan names in the ED table. Additionally, more students who saw the redesigned table accurately remembered the earlier plan attributes, like total interest (76% vs. 69%)[4] and repayment term (93% vs. 75%).[5] Despite these differences, both groups of students chose repayment plans at similar rates, with around 66%-67% selecting the Standard Repayment Plan.

Simply having to make an active choice among plans also appeared to help students select plans better suited for their circumstances. Interestingly, students in both groups still chose the Standard Plan at the same rate (66%-67%). This rate is telling because typically students are entered into the Standard Plan automatically without actively being asked to choose. Initially, this is likely to be nearly 100% of students. The 66%-67% of participants choosing the Standard Plan in our experiment is actually much closer to the 56% of the actual borrower population that eventually ends up on the Standard Plan—the majority of whom are already many years into repayment. This finding suggests that prompting students to actively choose a plan at the start gets them closer to their ultimate plan preference as borrowers.

A follow-up online study to assess the impact of naming a repayment plan as 'Standard' found no evidence for an effect on preferences for the various repayment plans. People who saw a repayment plan table that renamed the 'Standard' Plan as 'Fixed' were just as likely to select the Standard Plan as those who saw the unmodified ED table. Similarly, people continued to select the actual Standard Plan when other plans had been renamed as 'Standard.'

Lessons for the Future

Our in-person experiment suggests that we can help borrowers make plan choices that take into account key differences among plans by implementing minor changes to how repayment plan information is presented: providing concise plan descriptions, highlighting select plan attributes, and facilitating comparison among plans. Though this information may not be enough to help borrowers avoid plans unsuitable for them, it facilitates borrowers' understanding of them.

Moreover, our experiment results suggest that simply prompting borrowers to choose a plan earlier could get them closer to selecting the right plan for themselves. This would potentially help new borrowers circumvent the payment difficulties that eventually lead to changing plans. However, because our experiment did not set out to test this hypothesis, we recommend further research to replicate the result.

As the sheer volume of student debt grows each year, it becomes increasingly important to ensure that borrowers can use the full set of repayment tools the federal government has created to avoid financial distress. Future testing in a real-world setting will seek to identify ways to help borrowers select plans suited to their circumstances earlier on and more proactively. Using behavioral insights to improve the context in which borrowers make decisions about their repayment plan has the potential to help millions stay in control of their financial lives.

Notes

[1] This 14 percentage point difference is statistically significant ($p<0.01$)

[2] This 7 percentage point difference is not statistically significant ($p=0.12$)

[3] This 9 percentage point difference is statistically significant ($p=0.01$)

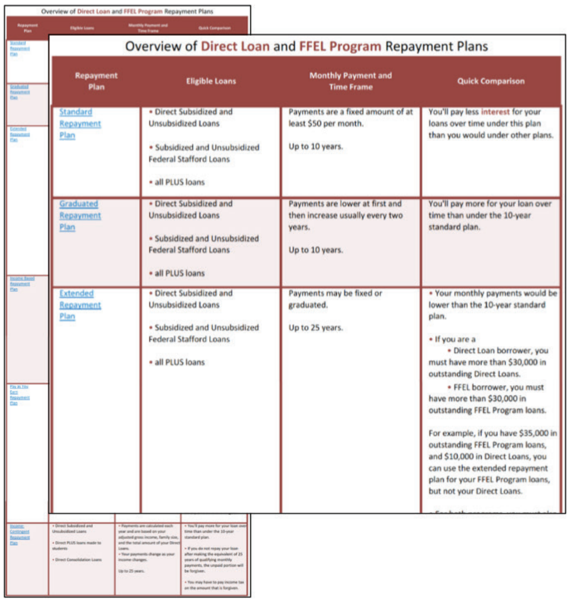
[4] This 7 percentage point difference is not statistically significant ($p=0.13$)

[5] This 18 percentage point difference is statistically significant ($p<0.01$)

[6] In 2015:Q3, the time of this study, 56% of borrowers were enrolled in the Standard Plan (https://studentaid.ed.gov/sa/about/data-center/student/portfolio)

Annex

Department of Education repayment plan table



Overview of Direct Loan and FFEL Program Repayment Plans

Repayment Plan	Eligible Loans	Monthly Payment and Time Frame	Quick Comparison
Standard Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • all PLUS loans	Payments are a fixed amount of at least $50 per month. Up to 10 years.	You'll pay less interest for your loans over time under this plan than you would under other plans.
Graduated Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • all PLUS loans	Payments are lower at first and then increase usually every two years. Up to 10 years.	You'll pay more for your loan over time than under the 10-year standard plan.
Extended Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • all PLUS loans	Payments may be fixed or graduated. Up to 25 years.	• Your monthly payments would be lower than the 10-year standard plan. • If you are a • Direct Loan borrower, you must have more than $30,000 in outstanding Direct Loans. • FFEL borrower, you must have more than $30,000 in outstanding FFEL Program loans. For example, if you have $35,000 in outstanding FFEL Program loans, and $10,000 in Direct Loans, you can use the extended repayment plan for your FFEL Program loans, but not your Direct Loans.

Redesigned repayment plan table

Overview of Repayment Plans

Repayment Plan	How long you'll pay for	How much you'll pay every month (the first and final month amounts)	How much you'll pay in interest (in addition to the $30,000 loan)
Blue	10 years	$311	$11,429
Red	14 years	$263 to $305 (increases or decreases depending on your income)	$16,678
Green	25 years	$208	$32,468
Purple	10 years	$179 to $538 (increases over time)	$14,580

Left: *Department of Education table of repayment plan information, available at https://studentaid.ed.gov/sa/repay-loans/understand/plans*

Right: *Redesigned table (version 1 of 4, balanced for order of plans and names)*

Example: Redesigned tables