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THE GOVERNMENT'S PLAN TO REDUCE STUDENT-LOAN DEFAULTS HELPS BORROWERS WHO NEED IT LEAST

Borrowers enrolling in income-based repayment plans tend to have high credit scores and student-loan balances, a new study shows

By Josh Mitchell
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The Obama administration has sought to stem a surge in Americans defaulting on their student loans by slashing borrowers' monthly payments through so-called income-based repayment plans.

Enrollment in the plans – which set borrowers' bills as a small percentage of their incomes – has soared over the past three years. But new research shows there's a flaw in the administration's strategy: The program isn't reaching many borrowers who need it the most.

A study published Tuesday by the Urban Institute, a left-leaning think tank, shows that the programs have only modestly reduced defaults. The reason: Borrowers who have enrolled in the plans are the least likely to default in the first place.

These borrowers tend to have higher student-loan balances and credit scores than those who remain in standard repayment plans, the study shows. That suggests they attended well-regarded colleges – which charge higher tuition than less-regarded ones – and graduate, medical and law schools. Such borrowers are much more likely to be employed and earning high salaries than those with lower credit scores and balances.

The implication is income-based repayment is largely helping white-collar workers while failing to reach a big chunk of the college dropouts and graduates of for-profit schools and community colleges, who studies show are most likely to default.

"It appears that borrowers who choose to use modified repayment have many characteristics that already make them less likely to default," writes Urban Institute research associate Kristin Blagg, the study's author.

Ms. Blagg used credit-bureau records to examine a random sampling of five million consumers, focusing on borrowers whose student-loan payments first came due in the 12 months through August 2012. Borrowers in modified payment plans, the most popular being some form of income-based repayment, owed an average $33,300 in principal, compared with $15,700 for those who stayed in standard repayment plans.

She showed that 8% of borrowers with modified plans later defaulted, which she defines as having gone more than 120 days without making a payment. By comparison, 19% of borrowers in standard plans defaulted, leaving an 11-percentage-point spread between the two groups. But when controlling for characteristics such as age, previous delinquency, loan principal, credit score, and location, the spread shrinks to three percentage points, Ms. Blagg writes.

It’s not clear why more troubled borrowers aren’t enrolling in income-based repayment.

Most borrowers in default on their loans owe less than $10,000. The reason: Many attended school – mainly community colleges or for-profit trade schools – for a short time before dropping out. A White House report in July showed that among borrowers whose initial payments came due in 2011, two-thirds of those who defaulted in the following three years owed less than $10,000.

There are several theories among academics: Many borrowers feel they were duped by their colleges and shouldn’t have to repay a single penny. Others are prioritizing other bills – credit card bills, car payments – and ignoring their student-loan payments. And the companies that the government hires to collect payments from borrowers, known as loan servicers, may not be sufficiently making them aware of their options, including income-driven repayment.

The administration has said the growth in defaults is slowing, largely due to a continued rise in enrollment in income-based repayment, and that it is working with those servicers to develop better strategies to reach troubled borrowers.