

Manageable Student Debt Threshold Research

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Outline of the presentation

- Motivation
- Literature review
- Student debt thresholds in Canada
- Practices of the private sector in Canada
- Issues with the current public loan system
- Considerations to improve the current public loan system
- Conclusions

Motivation

- Recent cohorts of students are more likely to:
 - borrow
 - borrow higher amounts to finance their PSE
- Student debt is unmanageable for a substantial proportion of borrowers
 - High delinquency (62.4%) and default (13.4%) rates of CSLP loans
- Understanding the threshold of manageable student debt, crucial
 - to **prevent** student borrowers' hardship
 - to **reduce** student borrowers' hardship
- Unfortunately, not much is known about what constitutes manageable student debt

Research questions

1. What are the different definitions and concepts of debt manageability?
 - What are the student debt thresholds in Canada?
2. How do the public and private financial sectors measure and calculate manageable debt?
3. What are the gaps in repayment mechanisms in the current system?
 - Are there ways to improve the current system?

Literature review - Manageable debt thresholds

- No consensus definitions of manageable debt
 - Definitions of hardship are subjective (Hansen, 1991)
 - Baum and Schwartz (2006):
 - The most commonly used indicators are arbitrarily derived
 - No single indicator / threshold can answer the question “how much students can borrow without risking repayment difficulties?”
- Ability-to-repay theory
 - Borrowers in financial distress choose options with the least net “harm”
 - “Prioritize” among their debts
 - Delinquency and default: rational decisions on the part of the borrower (Cohen-Cole & Morse, 2010)

Student debt thresholds in Canada

- 4 definitions are considered in the paper:
 1. Rule of thumb of 8 per cent cut-offs
 2. Over-indebtedness ratio
 3. Maximum discretionary income available with respect to LICO
 4. Maximum discretionary income available with respect to MSOL

- Summary of the results:
 - Thresholds vary by group characteristics
 - Gender, income, educational attainment labour force status

 - Thresholds vary across provinces

 - Up to a quarter of student borrowers have difficulty managing their debt

Selected results - Maximum discretionary income available for debt repayment with respect to MSOL

| | | After-tax Family Monthly Income Percentiles | | | | | |
|-----------------------------------|---------------------------|---|---------------|---------------|---------------|---------------|--------------|
| | | 5% | 10% | 15% | 25% | 50% | 75% |
| Overall | | -2,643 | -1,792 | -1,315 | -512 | 1,294 | 3,571 |
| Gender | Female | -3,036 | -2,208 | -1,652 | -840 | 1,132 | 3,401 |
| | Male | -3,008 | -2,336 | -1,709 | -924 | 939 | 3,261 |
| Employment Status | Employed | -2,627 | -1,669 | -1,075 | -77 | 1,688 | 3,946 |
| | Unemployed | -3,760 | -3,020 | -2,756 | -2,473 | -1,315 | 394 |
| | Not in the Labour Force | -3,508 | -2,945 | -2,723 | -1,951 | -644 | 1,313 |
| Highest Education Achieved | High School | -3,015 | -2,612 | -1,963 | -1,170 | 266 | 1,819 |
| | University Below Bachelor | -2,865 | -2,256 | -1,393 | -689 | 1,283 | 4,181 |
| | Bachelor's | -2,791 | -1,769 | -1,056 | -81 | 2,193 | 4,578 |
| | University Above Bachelor | -2,954 | -1,791 | -1,487 | 198 | 2,445 | 5,144 |

Selected results - Maximum discretionary income available for debt repayment with respect to MSOL, by Province

| | Before Tax Individual Monthly Income Percentiles | | | | | |
|---------------------------|--|---------------|---------------|-------------|-------|-------|
| | 5% | 10% | 15% | 25% | 50% | 75% |
| Overall | -2,643 | -1,792 | -1,315 | -512 | 1,294 | 3,571 |
| Alberta | -3,250 | -2,275 | -1,691 | -747 | 1,502 | 4,307 |
| British Columbia | -3,016 | -2,177 | -1,384 | -718 | 1,318 | 3,582 |
| Manitoba | -1,723 | -1,142 | -672 | -61 | 1,654 | 3,518 |
| New Brunswick | -1,590 | -917 | -415 | 20 | 1,524 | 3,342 |
| Newfoundland and Labrador | -1,445 | -841 | -494 | 24 | 1,452 | 3,602 |
| Nova Scotia | -2,360 | -1,540 | -1,144 | -486 | 944 | 2,977 |
| Ontario | -2,791 | -2,047 | -1,556 | -735 | 1,280 | 3,608 |
| Prince Edward Island | -1,590 | -863 | -563 | -3 | 1,319 | 3,227 |
| Quebec | -2,122 | -1,483 | -1,019 | -413 | 1,002 | 2,988 |
| Saskatchewan | -2,051 | -1,360 | -662 | 103 | 1,892 | 4,261 |

Practices of the private sector in Canada

- Student lines of credit: small but growing part of private lenders' portfolio
- Qualifications for student loans and lines of credit
 - Based on ability to pay rather than financial needs
 - “*how much debt **CAN** be taken on, instead of how much **SHOULD** be taken on*”
 - **Gap:** potential need for more public financial aids
 - Students with no income nor credit history are required to have co-signer
 - co-signer's credit worthiness determines maximum borrowable amounts
 - **Risk:** student may incur more debt than they can manage after graduation
- Industry standards for maximum permissible debt load are arbitrarily set
 - E.g., 32 per cent Gross Debt Service and 40 per cent Total Debt Service
- Level of risk tolerance: “cyclical” with the overall credit market

Practices of the private sector in Canada (2)

- No pre-determined thresholds for
 - “reasonable” living expenses
 - “manageable” repayment levels
- “Manageable” repayment
 - Based on detailed, comprehensive assessment of individual circumstances
 - net income, assets, liabilities, monthly and irregular expenditures, life factors
 - Consensus: students’ ability to budget the impact of the loan is crucial:
 - SMART principles to help clients get out of debt
 - Financial literacy is thus a major determinant in unmanageable private student loans

Issues with the current public loan system

- The majority of borrowers is able to repay their debt
 - However, high delinquency (62.4%) and default (13.4%) rates of CSLP loans
- Mortgage-style repayment system can be constraining
 - For example, for low income borrowers or if special circumstances occur
- According to key informants: low financial literacy is a problem
 - Mortgage-like repayment system is challenging for some borrowers
 - Unrealistic and overly optimistic expectations about future income:
 - students borrow more than what can be realistically paid back

Issues with the current public loan system (2)

- Existing programs contribute to alleviate the burden of repayment
 - Repayment Assistance Plans (RAP and RAP-BPD)
 - Assistance to borrowers who have difficulty with their repayment obligations
 - Repayment period is extended and debt cancelled after 15 years
 - 155,000 borrowers benefitted from RAP in 2009-10
 - 90% were not required to make any payment
 - Brings a fair amount of income-contingency in the Canadian system
 - Monthly repayments, cannot exceed 20% gross family income
 - Allows to pay back what borrowers can *reasonably* afford
 - Affordability based on: family income, family size and loan balance
 - Loan forgiveness programs targeting health and education sectors
 - Tuition rebates
- However, issues exist with these programs

Issues with the current public loan system (3)

- Issues with the RAP and RAP-BPD
 - Enrolment is not automatic: borrowers have to apply every 6 months
 - Application process is time consuming
 - Borrowers have to be in good standing to be eligible for RAP
 - Borrowers who miss payments cannot receive additional student loans and grants

- Loans forgiveness programs and tuition rebates
 - Not designed to help students with difficulty in managing their student debt
 - Provide incentives to specific group of borrowers

Considerations – Building on existing program structure

“Students really have not received the education on how to manage their money, they’ve never been taught ... [The] problem we see is students not having a grasp of what they’re really getting into”

- Financial literacy is a major issue in unmanageable student debt
- There is a need for interventions (such as LAHS) to improve:
 - financial planning for students
 - financial literacy of students
- Incentives could be provided to attend money management session
 - E.g., eligibility to CSLP funding could be conditional on attendance

Considerations for the design of public student loan programs

- The institutional framework of the aid system fosters the manageability of student debt
- An effective mortgage style student loan program requires:
 - borrowers to have sufficient financial literacy
 - sophisticated monitoring to prevent costly loan defaults
- RAPs bring income-contingency features and are effective
 - However, they have issues, especially with respect to eligibility status
- Consideration:
 - Introduction of a full income-contingent repayment scheme

Income-contingent repayment (ICR) system

- ICR ensures low-income borrowers are not overburdened
 - Decreases the non-insurable risk that students face
 - Little need for debt management programs
- ICR's simplified repayment rules decrease the financial planning needed
- Guillemette (2006) on an introduction of an ICR system in Canada.
It could:
 - encourage risk-averse students to pursue PSE
 - help increase the attendance of underrepresented categories of students
 - bring changes in the relative attractiveness of disciplines

Main features of ICR in other countries

- Income thresholds represent a substantial proportion of the country's median or average household income
 - 75% of median household income in Australia
 - 80% of the average household income in the UK
- Repayment rates are not based on rigorous empirical evidence
 - **Australia:** Up to 8% of *repayment* income above repayment threshold
 - **UK:** 9% of gross income above repayment threshold in the UK
 - **USA:** Up to 20% of *adjusted* income

Issues to consider if introducing an ICR

- Moral hazard (MH) and adverse selection (AV)
 - ICR is a sort of insurance against unmanageable debt. As such:
 - ICR could change the behaviour of insured (MH)
 - Only students with bad risks would have an incentive to join the program (AV)
- Introducing an ICR system implies “practical” consideration:
 - Coordination between student loan programs and tax authorities
 - The ability to collect repayments from borrowers who live overseas

Conclusions (1)

- Applying common definitions of thresholds produces a variety of thresholds
 - Up to a quarter of student borrowers have difficulty managing their debt
- Management of most student loan options based on traditional concepts
 - Lack of evidence or theory to justify thresholds of such concepts
 - Private sector does not have any special program to ensure manageability of student debt
- The RAP has provided some income-contingent loan features
 - However, strict rules restrict access to borrowers with most difficulties
- Financial literacy: most important factor for student debt manageability

Conclusions (2)

- Potential solutions to improve student debt manageability
 - Building on the existing system:
 - Interventions (such as LAHS) to improve financial planning for students and financial literacy of students

 - Rethinking student loans:
 - Introduce an income-contingent repayment scheme in Canada
 - Ensures low-income borrowers are not overburdened
 - Simplified repayment rules decrease the financial planning needed
 - Could increase the attendance of underrepresented categories of students
 - However, such a system implies theoretical as well as practical issues to be considered

MOVE BACK HOME?!... KIDS TODAY ARE SO LAZY AND IRRESPONSIBLE! YOUR MOTHER AND I STARTED OUT WITH NOTHING!...



FIVE-FIGURE STUDENT LOAN DEBT

TRUST ME, I WOULD'VE LOVED STARTING OUT WITH NOTHING!...

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JEFF PARKER

JimHensFlntoday.net

Appendix - 8-percent thresholds on before-tax monthly income

| | | Before Tax Individual Monthly Income Percentiles | | | | | | | |
|-----------------------------------|---------------------------|--|-------|-------|--------|--------|--------|--------|--------|
| | | 5% | 10% | 15% | 20% | 25% | 50% | 75% | 90% |
| Overall | | 6.67 | 33.33 | 53.33 | 73.33 | 93.33 | 186.67 | 293.33 | 500.00 |
| Gender | Female | 6.67 | 26.67 | 46.67 | 66.67 | 80.00 | 160.00 | 246.67 | 420.00 |
| | Male | 6.67 | 40.00 | 66.67 | 93.33 | 113.33 | 220.00 | 333.33 | 560.00 |
| Employment Status | Employed | 26.67 | 60.00 | 86.67 | 106.67 | 126.67 | 213.33 | 313.33 | 520.00 |
| | Unemployed | 0.01 | 6.67 | 20.00 | 33.33 | 46.67 | 106.67 | 186.67 | 360.00 |
| | Not in the Labour Force | 0.01 | 0.01 | 6.67 | 13.33 | 26.67 | 66.67 | 133.33 | 320.00 |
| Highest Education Achieved | High School | 6.67 | 26.67 | 46.67 | 66.67 | 80.00 | 160.00 | 246.67 | 413.33 |
| | University Below Bachelor | 0.01 | 20.00 | 40.00 | 66.67 | 86.67 | 186.67 | 286.67 | 486.67 |
| | Bachelor's | 6.67 | 40.00 | 66.67 | 93.33 | 120.00 | 240.00 | 353.33 | 580.00 |
| | University Above Bachelor | 6.67 | 26.67 | 53.33 | 73.33 | 100.00 | 220.00 | 373.33 | 646.67 |

Appendix - Over-indebtedness threshold on monthly income

| | | Before Tax Individual Monthly Income Percentiles | | | | | | | |
|-----------------------------------|---------------------------|--|--------|--------|--------|--------|--------|--------|----------|
| | | 5% | 10% | 15% | 20% | 25% | 50% | 75% | 90% |
| Overall | | 14.60 | 68.46 | 114.98 | 150.61 | 189.80 | 370.48 | 584.00 | 996.45 |
| Gender | Female | 14.60 | 58.40 | 94.13 | 129.43 | 160.60 | 319.38 | 502.07 | 830.38 |
| | Male | 14.60 | 87.60 | 133.35 | 178.85 | 233.20 | 438.35 | 670.89 | 1,124.20 |
| Employment Status | Employed | 58.83 | 127.75 | 175.20 | 217.18 | 255.50 | 424.44 | 627.80 | 1,037.17 |
| | Unemployed | 0.01 | 14.60 | 43.80 | 73.00 | 89.43 | 217.18 | 379.60 | 725.66 |
| | Not in the Labour Force | 0.01 | 0.01 | 13.69 | 29.20 | 47.07 | 131.40 | 265.80 | 638.75 |
| Highest Education Achieved | High School | 13.69 | 58.40 | 102.20 | 129.43 | 162.43 | 317.70 | 492.90 | 821.50 |
| | University Below Bachelor | 0.01 | 43.80 | 87.60 | 127.75 | 164.73 | 365.00 | 576.57 | 970.90 |
| | Bachelor's | 14.60 | 76.65 | 129.43 | 178.85 | 233.60 | 479.21 | 706.00 | 1,162.53 |
| | University Above Bachelor | 11.77 | 51.10 | 102.20 | 152.97 | 191.63 | 438.13 | 741.30 | 1,270.20 |

Appendix - Maximum discretionary income available for debt repayment with respect to LICO

| | | After-tax Family Monthly Income Percentiles | | | | | | | |
|-----------------------------------|---------------------------|---|-------|------|------|------|------|------|-------|
| | | 5% | 10% | 15% | 20% | 25% | 50% | 75% | 90% |
| Overall | | -789 | -253 | 110 | 438 | 756 | 2404 | 4767 | 9748 |
| Gender | Female | -1033 | -429 | 25 | 521 | 837 | 2633 | 4952 | 9482 |
| | Male | -1036 | -397 | 82 | 585 | 990 | 2670 | 4987 | 9393 |
| Employment Status | Employed | -631 | 180 | 756 | 1198 | 1538 | 3293 | 5525 | 9955 |
| | Unemployed | -1413 | -1071 | -800 | -393 | -371 | 527 | 2755 | 6450 |
| | Not in the Labour Force | -1381 | -1108 | -727 | -509 | -371 | 1149 | 3142 | 7322 |
| Highest Education Achieved | High School | -1006 | -493 | -61 | 370 | 669 | 1977 | 3785 | 8180 |
| | University Below Bachelor | -1171 | -243 | 552 | 899 | 1257 | 2888 | 5806 | 9343 |
| | Bachelor's | -883 | 102 | 603 | 1100 | 1491 | 3652 | 6030 | 11018 |
| | University Above Bachelor | -1137 | -295 | 460 | 1206 | 1862 | 3991 | 6639 | 12158 |

Appendix - Maximum discretionary income available for debt repayment with respect to LICO, by Province

| | Before Tax Individual Monthly Income Percentiles | | | | | | | |
|----------------------------------|--|------|-----|-----|-------|-------|-------|--------|
| | 5% | 10% | 15% | 20% | 25% | 50% | 75% | 90% |
| Overall | -789 | -253 | 110 | 438 | 756 | 2,404 | 4,767 | 9,748 |
| Alberta | -970 | -215 | 298 | 701 | 1,124 | 3,139 | 5,930 | 10,827 |
| British Columbia | -966 | -415 | 12 | 368 | 687 | 2,348 | 4,786 | 10,397 |
| Manitoba | -687 | -135 | 163 | 549 | 786 | 2,254 | 4,194 | 8,375 |
| New Brunswick | -577 | -38 | 343 | 601 | 890 | 2,262 | 4,127 | 7,799 |
| Newfoundland and Labrador | -245 | 139 | 423 | 743 | 1,016 | 2,516 | 4,583 | 8,778 |
| Nova Scotia | -805 | -100 | 190 | 410 | 658 | 1,988 | 4,118 | 8,424 |
| Ontario | -786 | -228 | 83 | 444 | 789 | 2,643 | 5,017 | 9,895 |
| Prince Edward Island | -200 | 243 | 584 | 779 | 947 | 2,295 | 4,321 | 7,886 |
| Quebec | -785 | -330 | 25 | 307 | 574 | 1,878 | 3,824 | 7,507 |
| Saskatchewan | -439 | 86 | 376 | 714 | 1,020 | 2,700 | 5,201 | 9,693 |

Consultations with key informants

| | Number of organizations approached | Interviews completed |
|---------------------------------|------------------------------------|----------------------|
| Credit counselling agencies | 7 | 5 |
| Private lenders | 14 | 2 |
| Student counselling and support | 3 | 2 |
| Academic experts | 8 | 4 |
| Credit bureaus | 2 | 0 |
| Total | 34 | 13 |