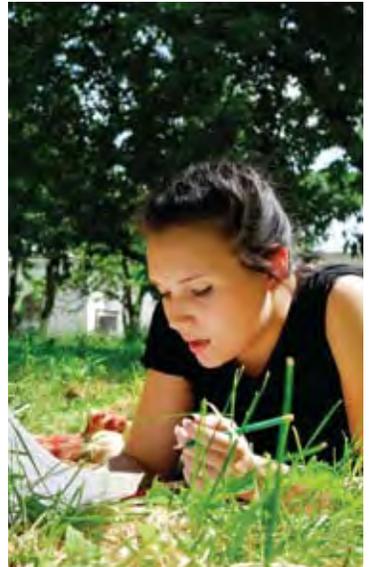


# CHALLENGES IN CANADIAN POST-SECONDARY EDUCATION



## Tallying the Costs of Post-secondary Education: The Challenge of Managing Student Debt and Loan Repayment in Canada

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## INTRODUCTION

As the global marketplace becomes increasingly competitive and knowledge-driven the potential social and economic benefits of education have increased. As a result, the past few decades have witnessed an unprecedented expansion in the demand for post-secondary education (PSE) worldwide.

The Canadian Council on Learning monograph series, *Challenges in Canadian Post-secondary Education*, was launched in November 2009 as a means of examining the impact of this expansion on the PSE sector.

The first two monographs explored issues of quality and typology. This third monograph in the series examines various policy approaches to student loan repayment in government student financial-aid programs, specifically the Canada Student Loans Program (CSLP).

The aim of this discussion is to highlight the CSLP's complexity as a vehicle for promoting equitable access to PSE, particularly for students from lower-income families. This monograph, therefore, brings to light various methods through which student loan repayment may be managed, and evaluates current program approaches.

The funding of Canada's PSE system is predominantly public in nature with the majority of institutional revenues being sourced from a combination of government grants and student tuition fees. Policies regarding tuition levels vary among provinces and over time. Nevertheless, over the past few decades students have shouldered an increasing share of the cost of obtaining a post-secondary education in Canada.

Not everyone views this trend as problematic. Citing high personal returns to investments in education, those who support higher tuition fees think it is appropriate that those who benefit most from PSE should bear a larger proportion of its costs. Those who oppose this view argue that higher tuition fees have the potential to price students from lower-income backgrounds out of the market, creating inequitable access for these students. This concern provides the rationale for the existence of various types of student financial aid, including government-sponsored student loans. In fact, part of the stated mission of the CSLP is "to promote accessibility to post-secondary education for students with a demonstrated financial need by lowering financial barriers through the provision of loans and grants."<sup>1</sup>

It is not surprising, therefore, that much of the research on tuition and student finance has focused on issues of access, participation, and the characteristics of students and borrowers. In the 10 years prior to closing its doors in March 2010, the Canada Millennium Scholarship Foundation contributed a substantial body of quality research literature in this area. However, as Luong (2010) observes "little research has been directed at exploring the impact that student loans may

have on individuals' financial position after graduation."<sup>2</sup> Moreover, Kapsalis (2006) notes that policy-makers are particularly interested in the issue of whether graduates are able to repay their loans.<sup>3</sup>

The CSLP has established a mortgage-style repayment model with fixed payments, fixed repayment periods, and relatively high interest rates. There is speculation that high student debt-loads may force graduates to "forego careers that are not remunerative, postpone marriage, to postpone having children, or, in general, to be unable to participate fully in adult life."<sup>4</sup> Luong (2010) discovered that PSE graduates who had borrowed were less likely than non-borrowing graduates to have retirement savings and investments, and were less likely to own their own homes.<sup>5</sup> Moreover, she also found that the proportion of students graduating with student debt increased from 49% in 1995 to 57% in 2005.\*<sup>6</sup>

Although these issues are of immediate concern to graduates, concerns over debt repayment may indirectly affect prospective students' access to PSE. Some analysts argue that fears of unmanageable debt repayment after graduation may deter some potential students from applying for student loans, or possibly discourage them from considering PSE altogether. Guillemette (2006) suggests that "people from poorer socioeconomic backgrounds may be more averse to borrowing and the possibility of default," a phenomenon known as "debt-aversion."<sup>7</sup> Burdman (2005) found that "low-income students are less likely to borrow than other students, and when they do borrow, they take smaller loans."<sup>8</sup> Moreover, Eckel and colleagues (2007) suggest that "risk-averse persons are less likely to take up any form of education financing."<sup>9</sup>

For these reasons, some have advocated income contingent repayment (ICR) systems, (i.e., loan payments based on a percentage of the borrower's post-graduation income). The idea of ICR is controversial, particularly among student advocacy groups, partly because where such schemes have been implemented they have been accompanied by steep tuition hikes. Moreover, ICR repayment periods for low-income borrowers can be extended to what some have characterized as a "lifelong debt sentence."<sup>10</sup>

Clearly, large student-debt burdens could put a growing proportion of young adults at a financial disadvantage relative to graduates who have not borrowed. Of particular concern is the possibility that students from lower-income backgrounds—one of the CSLP's targeted populations—may not choose to attend PSE because of concerns about acquiring large student debt. These concerns need to be addressed. A close, informative look at issues of student loan repayment in Canada represents a critical first-step in that process.

Accordingly, this monograph is organized into five parts. The first part provides background information regarding student financial assistance and the various ways through which it is offered in Canada. Part II reviews issues of student debt loads and repayment in Canada, drawing from research studies and anecdotal accounts. Part III offers a broad overview of various types of repayment

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\* This includes not only government-sponsored debt, but also student debt owed to private lenders, family and other sources.

systems, supplemented by international examples. Part IV provides an in-depth look at repayment in the context of the CSLP, including recent changes and provincial variations. The concluding section provides a critical review of the issues discussed, and recommends further steps that may be taken to ensure manageable student-debt repayment in Canada.

## PART I: BACKGROUND

### THE INHERENT RISK TO SPECIFIC INVESTMENTS IN HUMAN CAPITAL

Armbruster (2008) noted that human capital theory has provided the “master narrative” behind the move toward financing the expansion of post-secondary education systems in many jurisdictions.<sup>11</sup> As Oldford and Ungerleider (2009) elaborate:

Human capital theory explains differences in earnings among individuals by variations in investments in education and training. The logic behind this theory holds that investments in education and training increase the abilities and productivity of an individual ... [improving] ... one’s position in the labour market, allowing one to compete for higher wages. It also follows that these investments, in aggregate, contribute to increased productivity among firms, yielding economic and societal benefits.<sup>12</sup>

It follows that students and society at large should share the costs of the provision of PSE, as they both benefit from investments in human capital. Riddell (2007) reminds us, however, that “human capital investment is risky,” particularly at the level of the individual, because the benefits “typically accrue over a long period, in the form of a higher earnings stream ... over many years ... typically, there is uncertainty about the extent to which the investment will pay off.”<sup>13</sup>

In aggregate terms, post-secondary education bestows significant private benefits to those who engage in it. A PSE credential attests to the acquisition of a certain set of marketable skills and knowledge, and signals to potential employers that the graduate possesses the commitment and competency required to obtain that credential. Presumably, this increased marketability enables graduates to compete for higher-paying, more stable and more satisfying jobs. Research has shown that nine in 10 Canadians see a university education as a good investment.<sup>14</sup>

There is ample evidence to substantiate this perception. For example, a recent report by the Canada Millennium Scholarship Foundation notes that “over the course of 40 years, a college graduate will earn \$394,000 more than a high school graduate,” while a bachelor’s degree holder will earn a premium of \$745,800.<sup>15</sup> According to the Organisation for Economic Co-operation and Development (2008), university graduates in Canada “have a much greater chance of finding jobs relative to individuals with lower levels of education,” and both male and female graduates earn about 38% more than those with only a high-school diploma.<sup>16</sup>

Society also stands to benefit since the increased human capital that results from higher education leads to productivity gains and a healthier economy overall. Moreover, the higher earnings of educated people contribute to the tax base for governments at all levels, creating more public wealth. Baum and Ma (2007) found that “all workers, regardless of education level, earn more when there are more college graduates in the labor force.”<sup>17</sup> Furthermore, other positive social behaviours have been positively linked to higher levels of education, including civic participation, charitable giving, and healthy living.<sup>18</sup>

However, the high personal returns to PSE investments that economic studies reveal are measured in aggregate terms. As Guillemette (2006) notes, “investing in education at the post-secondary level involves a certain degree of risk for students, especially if they must rely on student loans.”<sup>19</sup> Finnie and Schwartz (2002) explain that “because student loans are offered to young people without any consideration of their future ability to repay, fears about excessive borrowing have been voiced since North American student loan programs were introduced in the 1950s and 1960s.”<sup>20</sup>

As Guillemette states, because “human capital acquisition at the post-secondary level produces highly variable individual returns,” graduates are not assured of an equitable share in the high personal returns that PSE can deliver.<sup>21</sup> There are many reasons why returns on investments in PSE vary for individuals. The first obvious reason is that successful program completion is uncertain. Second, different fields of study are associated with employment outcomes with variable potential to generate earnings. Third, a graduate must face the labour-market dynamics of the chosen field, ideally entering the market at a time when new graduates are in demand. Finally, continuous employment throughout one’s career is uncertain. Family or health issues could force a graduate to leave the labour force, or economic shifts may result in temporary or prolonged unemployment.

De Broucker (2005) voices concerns that these risks may disproportionately affect students from low-income backgrounds:

Students who fund their studies by borrowing heavily face big debt payments once they start working; that means that students from low-income families who manage to overcome the odds against getting a post-secondary education will once again find themselves pressed for money, possibly for many years after education.<sup>22</sup>

Guillemette (2006) notes that this possibility is particularly worrisome, as we know that students from low-income backgrounds “are already under-represented ... and possibly the most sensitive to risk considerations.”<sup>23</sup>

In its scan of relevant literature, the Canadian Council on Learning (2006) reported that “it is difficult to establish to what extent debt aversion pertaining to educational expenditure is a problem endemic to lower-income groups specifically. Rather, aversion to debt is shared by all those uneasy with the increasing costs of education, especially compared to smaller increases in real incomes.”<sup>24</sup>

Uncertain outcomes also pose risks to lenders. Prospective students have little or no security to offer on an educational loan aside from their anticipated but uncertain future wealth. As Connolly, Montmarquette and Béjaoui (2003) have noted, investments in human capital are peculiar because “they cannot be backed by material collateral” and offer “nothing tangible to the lending institution in case of default.”<sup>25</sup> The market for human capital is therefore imperfect, justifying government involvement in this segment of the money lending arena. Given the positive social benefits of a highly educated population, publicly provided student loan systems are generally considered to be good public policy.

### STUDENT FINANCIAL AID IN CANADA: THE COMPLEXITY OF THE CANADA STUDENT LOANS PROGRAM

Student financial aid in Canada is a collection of various mechanisms delivered through federal and provincial governments, post-secondary institutions, and private organizations. These mechanisms include: government loans and grants, education tax credits, programs to encourage saving for education, scholarships, and bursaries. Not all of these mechanisms focus on supporting students with a high degree of financial need, as is the stated purpose of the Canada Student Loans Program (CSLP).

The focus of this discussion is on student-loan repayment. This monograph does not provide an in-depth analysis of issues relating to other types of student financial aid (i.e., grants, scholarships and bursaries). This does not suggest, however, that student debt and repayment are unrelated to these other types of aid. Many variables combine to influence a borrower’s total student debt load outcome, including the availability of other forms of non-repayable student aid, family contributions, employment income, geographic variances in the cost of living, and the duration and cost of the program.

Further, the intention here is not to revisit the many existing studies and evaluations of CSLP’s needs-assessment processes, but rather to provide readers with an informed understanding of why and how some borrowers acquire higher debt levels than other graduates who have pursued similar programs of study. The CSLP is highly complex, more so than it needs to be, and this complexity can serve to deter potential students from borrowing. It can also complicate the process of debt repayment for borrowers, many of whom have only a partial understanding of what the process entails.

Some complications may arise because of provincial variations in the program. The CSLP is jointly administered by federal and provincial governments in the Yukon and in all provinces except Quebec which has its own student loan program. In some provinces (Saskatchewan, Ontario, New Brunswick and Newfoundland and Labrador) a student receives one loan, the administration of which has been integrated between federal and provincial levels. In other provinces, a student will actually receive two loans per disbursement: a federal portion, which accounts for about 60% of assessed need,<sup>26</sup> and a provincial portion that provides the remaining 40%.<sup>27</sup>

The CSLP offers loans and grants to students with demonstrated financial need. The amount awarded to a student loan applicant is based on an assessment of need that takes into account available resources and cost allowances. However, the loan is considered to be a supplement to family or student resources and may not be sufficient to cover all of the need as assessed.<sup>28</sup>

The level of assessed need can vary according to an individual's assessed expenses for a given study period, the particulars of program cost, cost of living, whether or not the applicant is living at home during the study period, and whether he or she has a spouse or dependent children.<sup>29</sup>

Needs assessment calculations may also vary depending on the applicant's circumstances. A distinction is made between "dependent" and "independent" students. Independents are those students who are married, have children, have been recently employed or who have been out of high school for more than four years. All other applicants are classified as dependent, and thus their parental income is taken into account in the needs assessment, with average loan amounts declining as parental income rises.<sup>30</sup>

Students of all public and designated-private PSE institutions may apply for a loan, but through two separate National Student Loan Service Centres (NSLSCs): one to administer direct loans disbursed to students of public institutions, and another for the students of private institutions.

Changes to the CSLP over time account in part for its current complexity. Since its inception in 1964, the CSLP has been delivered through three different lending schemes, which can serve to complicate the debt-repayment process of some borrowers. From 1964 to 1995, loans were provided through private financial institutions, although the loan amounts were guaranteed by the government. Between 1995 and August 2000, loans were still provided by financial institutions, but through a different type of risk-shared agreement. Since August 2000, the program was shifted to a regime that funds loans to students directly. Under this new regime, the appropriate NSLSC administers repayment of loans. Students carrying loans from prior to 2000 have a repayment agreement with a bank, and students carrying loans post-2000 repay their loan to the NSLSC. It is possible, therefore, for students to have loans in repayment under both of these frameworks.

In non-integrated provinces, a borrower in repayment has a provincial loan account and a national account with a NSLSC. Should that same borrower have pre-existing student loans from before 2000, then they also have an additional repayment agreement with a private financial institution. That number increases even further should the student require another loan in order to undertake an additional program at a private institution.

Administrative management of a borrower's total debt repayment may become increasingly difficult in situations in which the borrower accumulates multiple student loan accounts. With a growing number of accounts to administer, there

is increased risk of inefficient or waylaid paperwork, which can jeopardize a borrower's good standing. Schwartz (1999) reminds us that many students are young and may be unfamiliar with credit relationships and therefore confusion about repayment obligations may be a contributing factor when borrowers find themselves in default.<sup>31</sup> According to the Treasury Board Secretariat, in the provinces where integration has taken place the aim of this governance structure has been to facilitate a "one-student-one-loan" service approach.<sup>32</sup> Consolidating debts is undoubtedly the preferred option of borrowers and is often one of the first steps they take toward achieving more manageable debt repayment.

However, the CSLP's use of the word "consolidation" can be misleading and does not always lead to a one-student, one-loan approach. Rather, it refers to the terms outlined in the borrower's loan repayment agreement and to the commencement of repayment, both of which are typically undertaken following the student's completion or interruption of their study program.

The groundwork for consolidation is laid while the borrower is in study; during that period, the debt that a student accumulates through the CSLP does not accrue interest. Numerous loan disbursements are provided to students over a two- or four-year study period. Students may not require assistance in every year of study, and must submit a separate application for each year of study. To maintain their loan's interest-free status, borrowers still in school regardless of whether or not they continue to apply for and receive loans must regularly confirm with the NSLSC that they have maintained their enrolment. During this period, transactions between the borrower and lender generally do not deal with issues or information about the impending repayment period.

After completing or interrupting studies for a period of over six months, borrowers enter into a consolidation agreement that outlines the terms of repayment for the loans they have accrued. Repayment commences at this time. However, in provinces that are not integrated, borrowers are required to enter into two agreements, one federal and one provincial. CSLP borrowers may use various website calculators to estimate their future loan payment amounts. However, it is only at the time of consolidation that the monthly payment amount can be understood in relation to the borrower's actual post-graduation income and employment prospects, which often cannot be accurately known until the study period has ended.

As discussed, investments in post-secondary education are considered beneficial to society, although it is understood that high returns are not guaranteed at the individual level. For potential students, this implicit risk fuels apprehensions about incurring the real and opportunity costs necessary to complete PSE. The prospect of also taking on student debt can serve to exacerbate this perception of risk. Although widely available to support students with demonstrated financial need, the complexity of the CSLP may also be a source of apprehension among prospective borrowers and students.

Particularly troublesome is the possibility that some low-income students, precisely the target population of the CSLP, may be averse to taking on debt. Debt-aversion, misperceptions about costs, and imperfect information about the availability of student aid can all have an impact. As de Brouker (2005) observes, “low-income families have a much less realistic view of cost and income than people who can afford high tuition fees.”<sup>33</sup>

## PART II: CURRENT TRENDS IN STUDENT DEBT AND REPAYMENT

Measured from the perspective of the number of students served, the CSLP is a remarkably successful program. According to the program’s annual report for 2004–2005 loan year, “337,256 full-time post-secondary students received a Canada Student Loan for a total of \$1.6 billion.”<sup>34</sup> According to Berger (2009), when all types of Canadian student debt are taken into account “six in 10 university graduates and 45 percent of college graduates have amassed some student debt while in school” with each group owing an average of \$26,680 and \$13,600 respectively.<sup>35</sup> Further, undergraduate student debt reported in Canada doubled during the 1990s, from \$12,271 in 1990 to \$24,706 in 2000 (expressed in constant 2009 dollars).<sup>36</sup> In the following decade, however, average student debt increased by only 9%.

### MORE STUDENTS ARE BORROWING AND AVERAGE DEBT LOADS ARE INCREASING

The percentage of Canadian students relying on student loans to finance their education has increased over the past decade. On average, these students are borrowing significantly more than they were in the 1990s.<sup>37</sup> The fact that student loan programs have become more generous in recent years, increasing the maximum amounts of assistance, partially accounts for this trend.<sup>38</sup>

Luong (2010) notes that the proportion of graduates who had borrowed money to finance their education (from all sources including banks, family and government loans) increased from 49% in 1995 to 57% in 2005.<sup>39</sup> While the proportion of borrowers who owed only government-sponsored student loans over this period actually decreased from 67% to 52%, the proportion of those who owed to both government loans and other sources increased from 20% to 26%.<sup>40</sup> This may suggest that some students need to borrow beyond the maximum amount allowed under the CSLP and seek other sources of funding to finance their unmet need.

Average debt loads are also increasing. Using data from the National Graduates Survey (NGS), Luong (2010) found that “between 1995 and 2005, the average amount owing on government loans at graduation increased from \$14,700 to \$16,600,” while average loan amounts (taking into account all possible sources of funding) increased from \$15,200 to \$18,800 respectively.<sup>41</sup>

Despite the significant uptake of student loan programs, disparities in PSE participation rates persist between students from high- and low-income backgrounds, particularly for at the university level.<sup>42</sup> A recent study revealed that youth from high-income families are more than twice as likely to pursue university studies as youth from low-income families.<sup>43</sup> It appears that the CSLP has had limited success in redressing this disparity.

Continuous increases in tuition levels may magnify these issues, leading students to incur higher debt loads in the pursuit of education. Evidence shows that of graduates who had consolidated their loans in 1994–1995, one-third had defaulted on their loans within a 10-year period.<sup>44</sup>

### DEFAULT RATES ARE DECREASING

Under the CSLP's direct loan regime, a borrower is considered to be in default if the loan is in arrears for more than 270 days (nine monthly payments).<sup>45</sup> Defaulted loans are then turned over to commercial collection agencies that sometimes use aggressive tactics in their efforts to collect.<sup>46</sup> Moreover, a student loan in default can negatively affect a borrower's credit rating which can impact their ability to borrow later in life.

According to Human Resources and Skills Development Canada (2008), the majority of CSLP borrowers who default do so within three years of entering repayment.<sup>47</sup> For this reason, the three-year default rate is a key measure of the CSLP's performance. Overall, default rates declined from 28% in 2003–2004 to 17% in 2006–2007.<sup>48</sup> Borrowers who had attended private career colleges were over-represented among those in loan default during this period. A recent *Globe and Mail* article revealed that "students at private colleges are twice as likely to miss student-loan payments as their counterparts at public colleges and universities."<sup>49</sup> According to Church (2010), while career-college students made up only 17% of federal student loan recipients, they accounted for "more than 30% of the value of delinquent loans."<sup>50</sup> Private career colleges often charge high tuition fees and students who are unable to find high-paying jobs after graduation are thus at higher risk of default.

### BANKRUPTCY

In most circumstances, bankrupt debtors can claim bankruptcy in order to discharge their outstanding debts and obtain a clean credit rating. However, some types of debts cannot be discharged including alimony, child-support payments, fines, and some damages imposed by a court. In the late 1990s, in response to an increasing number of bankruptcies involving student loans, changes were made to the *Bankruptcy and Insolvency Act* (BIA). Since 1998, government student loans debt has been non-dischargeable in a bankruptcy if the bankruptcy occurred within 10 years of the end of the study period.<sup>51</sup>

In 2008, measures were introduced to reduce the period for which a student loan is non-dischargeable from 10 to seven years.<sup>52</sup> As revealed in Senate debates to amend the BIA in 2007, empirical research demonstrates that abuse

of the bankruptcy process is “not a factor in the non-reimbursement of student loans.”<sup>53</sup> According to Schwartz (1999), most people who have difficulty repaying their loans in full are unable—rather than unwilling—to pay.<sup>54</sup>

### HARDSHIP IN REPAYMENT: EVIDENCE FROM THE NATIONAL GRADUATE SURVEY

In 2003, Kapsalis used National Graduate Survey (NGS) data to investigate factors affecting student loan repayment among students who had consolidated their debt after graduating in 1994–1995 and were nearing the end of the typical 10-year repayment schedule. He found that nine years after consolidation “39% of student debtors had repaid their loans in full, while 30% were still making payments” and 31% of student debts were in default.<sup>55</sup> An interesting finding was that the difference between the average debt-load of those who had repaid their loans in full compared to those who had defaulted was negligible: \$6,500 compared to \$6,800. There were however, significant differences in the average income earned in the three years after consolidation between those who had repaid their loans and those in default. Kapsalis concluded that a borrower’s debt-load has less effect on their ability to repay their loan than their income does.<sup>56</sup>

However, Kapsalis also found that the rate of default rises for borrowers with large debt-loads. His analysis revealed that “within any given income bracket, the default rate is the same for loans up to about \$20,000” after which the default rate jumps by about 20 percentage points.<sup>57</sup>

Again using data from the NGS, Bayard and Greenlee (2009) found that a substantial proportion of graduates from the graduating class of 2005 had accumulated large debt-loads (defined as \$25,000 or over). It is not surprising that doctoral graduates had the highest incidence (35%) of large debt-loads, considering the many years of schooling required to pursue that degree level. However, 32% of baccalaureate graduates also had large debt-loads.<sup>58</sup>

The NGS also offers a subjective measure of hardship, asking students whether they experienced any difficulty in repaying their student loans. One in four graduates with government debt reported experiencing hardship in repaying their loans. Of those graduates with remaining debt two years after graduation, 33% of college graduates and 32% of bachelor’s graduates reported difficulty paying. It is surprising, however, that difficulties were reported even among those who had fully repaid their debt within two years of graduation. The largest proportions of graduates reporting difficulties were found among students holding large debt loads, with 45% of borrowers with debt loads of \$25,000 or more reporting difficulty.

An abundance of online anecdotal evidence generated over the past few years complements what can be learned from survey responses and administrative data sets. Proponents of student-aid reform have established a number of websites that allow students and borrowers-in-repayment to share their experiences and solicit advice or information from their peers. Although these sites likely attract individuals who have had negative student loan experiences

rather than positive ones, posts submitted to the message board website [www.canadastudentdebt.ca](http://www.canadastudentdebt.ca) indicate that loan repayment difficulties can be an extremely stressful experience.

It stands to reason that today's graduates may face significant repayment issues, thanks to the fact that they're carrying even higher debt loads than their predecessors and, because of regulations, are also unable to discharge their student loans through bankruptcy for seven years. Observing these disturbing trends begs the question, "How much student debt is too much?"

### HOW MUCH IS TOO MUCH?

As Schwartz (1999) notes, repaying a loan is by definition a process that almost inevitably imposes a financial burden on the borrower.<sup>59</sup> However, objective measures of hardship are difficult to identify because the notion of financial hardship is inherently subjective and variable. Consequently "there is no consensus on exactly what financial hardship might mean."<sup>60</sup>

Researchers often use debt-service ratios to express financial burden in monetary terms. The measure is calculated as a ratio of debt payments to earned income during a particular time frame and is "interpreted as the percentage of income devoted to debt repayments."<sup>61</sup> However, debt is not limited to student loans, just as perceptions of financial hardship are not only a function of the borrower's ability to repay. Other debts such as credit cards, lines of credit, car loans and mortgages can impact a borrower's ability to repay a student loan. However, available data rarely present student-debt levels along with other types of debts. Thus, the true debt-service ratio of a borrower-in-repayment is not easily understood.

Regarding the appropriate debt-servicing ratio for student loans, Finnie and Schwartz (2002) assert that "there remains no consensus on the proportion of income that can be allocated to a student loan."<sup>62</sup> A recommendation frequently put forth in the United States is that monthly student loan payments should not exceed 8% of gross income. This threshold is derived from mortgage underwriting standards that limit monthly housing payments to 25 to 29% of monthly income and total monthly debt-service payments to 36 to 41% of income.<sup>63</sup> In the Canadian context, Baum and Saunders (1998) have suggested that any amount over 10 to 12% is likely to cause hardship.<sup>64</sup> However, Bayard and Greenlee's study of the graduating class of 2005 showed that one in four bachelor's graduates with large government debt loads had debt-servicing ratios at or above 15%, exceeding most notions of what is manageable.<sup>65</sup>

As revealed earlier, a borrower's inability to repay student loans is more a function of their post-graduate income than the amount of student-debt that they have accrued. Given these issues, it is not altogether surprising that advocates for student loan reform frequently recommend a repayment regime that ties loan repayment levels to income. Accordingly, the next section examines different modes of student loan repayment schemes and their comparative benefits.

## PART III: DIFFERENT PROGRAM APPROACHES TO STUDENT DEBT REPAYMENT

As previously discussed, the availability of student loans may help to counteract the financial barriers faced by otherwise qualified and motivated post-secondary students. Yet as Usher (2005) notes, students' misperceptions and misinformation about the costs and benefits of PSE may be a more difficult barrier to overcome. Indeed, "many Canadians and those from low-income backgrounds in particular are making rational cost-benefit analyses which imply that they do not view university education as being 'a good investment.'"<sup>66</sup>

Moreover, Wigger and Von Wiezsäcker (2001) note that while publicly provided student loans "generally do not change the nature of individual educational risk," they may represent a "significant disincentive to invest in education" because the loan must be paid back irrespective of educational success.<sup>67</sup>

Thus, misperceptions about the costs and benefits of PSE coupled with risk- and debt-aversion toward student loans can serve as strong disincentives to PSE participation.

However, this need not be the case. It is possible to tailor student-loan repayment mechanisms to insure borrowers against these risks. For instance, governments may introduce an element of income contingency to their student loans programs.

Public student financial-aid systems can invoke essentially two approaches to debt-repayment: mortgage-style repayment (MSR) and income contingent repayment (ICR). The following section delineates the fundamental characteristics of these two approaches in their purest forms.

### MORTGAGE-STYLE REPAYMENT

A mortgage-style repayment (MSR) system for student loans is essentially a debt contract. In its most basic form, the MSR contract sets out an amortization schedule that anticipates repayment of the entire loan principal within a given time frame, usually about 10 to 15 years. Throughout the amortization period, the borrower makes regular payments of a fixed amount, as one would for a mortgage.

MSR is a simple debt instrument with which most people are familiar. The amortization period for MSR student loans generally begins after the borrower has ceased to be engaged in full-time study. As Finnie (2004) observes "student loans are in almost all cases interest-free while students are in school, which can represent a major subsidy."<sup>68</sup>

## INCOME CONTINGENT REPAYMENT

Income-contingent repayment (ICR) was the brainchild of U.S. economist Milton Friedman. An opponent of public subsidies for PSE, Friedman opined that it was inequitable to have taxpayers “many of whom had relatively low incomes, subsidizing the university education of children from families with relatively high incomes.”<sup>69</sup> He believed that a better approach would be for students to finance the entire cost of their non-compulsory education. Recognizing that few students would have the financial means, and that the risk of labour-market imperfections would likely deter banks from becoming involved, Friedman proposed a solution: that governments provide financial aid to students on the condition that borrowers’ repayment agreements are based on an agreed-upon percentage of their future earnings.

In this sense, Friedman’s version of ICR can be likened to a tax for graduates, whereby the fraction of earnings paid would be calculated in such a manner as “to make the whole project self-financing.”<sup>70</sup> Implicit to this arrangement is a cohort of borrowers among whom individual investment risks are pooled. The losses accrued by graduates who prove unsuccessful in repaying their loan are subsidized by the gains earned by successful graduates. Few real-world examples of ICR systems take this approach. Although the focus of the original ICR was to allow for private financing of PSE, current ICR approaches focus more on creating systems that protect borrowers against unmanageable debt payments, with the intention of counteracting risk- and debt-aversion.

## MSR VERSUS ICR: A COMPARISON

Most student financial aid systems exist to ensure that financial barriers alone do not prevent qualified students from attending school. Although increasing tuition costs may deter risk- and debt-averse individuals from pursuing PSE, the essential premise of the ICR approach is, however, is “to provide better protection against repayment burdens becoming unmanageable.”<sup>71</sup> Yet well-designed student-loan repayment programs must include other considerations, such as; the ease of program’s administration, the inherent risk of default and, potentially, the recovery of the loan program’s administrative costs.

One of the principle differences between the MSR and ICR systems is the repayment period. In MSR systems, the repayment period is fixed to the terms negotiated in the repayment agreement, as are scheduled payment amounts. Therefore, the percentage of income that a borrower is repaying throughout the repayment period varies according to the borrower’s income. Assuming that a borrower’s income increases over time, it is reasonable to assume that fixed payments may be more difficult to cope with earlier in the repayment period, when the repayment amount consumes a larger proportion of the borrower’s disposable income. In ICR schemes, the percentage of income that a borrower is repaying is fixed, while the payment amounts and duration vary with income level.

According to Thomas (1994), MSR loans “have drawbacks for both the lenders (a high default rate) and borrowers (higher interest rates because of high default rates, and the burden of a large debt immediately after graduation).”<sup>72</sup> Moreover, defaulting on a student loan can negatively affect a borrower’s credit rating,

resulting in further financial complications and potential bankruptcy. In such a repayment system, the unfortunate student who takes on high debt loads only to find poor wages upon graduation may actually find her financial situation worsen as a result of her PSE participation.

Under MSR frameworks students can predictably calculate, at the point of entering into the loan repayment agreement, the total amount of interest required over the entire amortization period. This is not the case under pure ICR frameworks: unless some sort of ceiling is put in place, the overall amount of interest that ICR borrowers will be required to pay depends on how quickly they can repay the loan.

Given a choice between MSR and ICR frameworks, students who anticipate sufficiently high wages are likely to opt for MSR because it costs less and they do not perceive any risk. Risk-averse students, however, may anticipate wage uncertainty; they are likely to perceive ICR as a convenient form of insurance against wage-related risk, and therefore are willing to pay a premium for this type of protection.

However, as Guillemette (2006) notes “the principal problem with risk pooling in an income-contingent repayment plan is the possibility of *adverse selection* [italics added], that is, the prospect that bad risks will drive good risks out of the program.”<sup>73</sup>

If too many “good risks” are driven out then the program will need government subsidies to remain sustainable. Depending upon whether the loan program’s objectives align with those of government, subsidization may not pose a problem. If a government’s objective in implementing ICR is to increase the PSE participation of lower-income students, subsidies may be acceptable, as this will mitigate risks for those students for whom the investment in education does not pay off.

Another important consideration is the need for accurate information about graduates’ income levels to ensure that the proper amounts of repayment are being collected. Proponents of ICR advocate the collection of student debt through the income-tax collection system. Should the tax department be amenable to this approach, the administrative costs of ICR could be significantly reduced. As Usher (2005) observes, tax officials are likely to oppose this approach as it “opens the door to using the tax system to collecting all sorts of debts, and this, they fear might put in jeopardy citizens’ willingness to truthfully self-report their income.”<sup>74</sup>

### The Politics Behind the ICR Debate

On the surface, the relative merits of MSR versus ICR can be framed in economic terms. However, decisions about whether to implement ICR also entail political considerations. For example, many who support lower tuition fees oppose ICR. They argue that ICR increases the debt management capacity of students, thus enabling institutions and governments to increase tuition fees. According to the Canadian Federation of Students (2005), the true purpose of ICR systems is “to shift the cost of education from the state to the individual,” citing that where ICR has been implemented it is “accompanied by higher tuition fees, higher debt loads, and extended repayment periods.”<sup>75</sup>

Another political consideration is gender. Under ICR schemes, student loan repayments for women on parental leave are adjusted to reflect lost or reduced income during such periods. A less attractive consequence for these women is a greater likelihood of longer ICR repayment periods. Therefore under ICR schemes, women as a group may incur higher debt costs.

Despite such considerations, hard-line economic and political conservatives are skeptical about government subsidizations in general. They tend to favour lower spending levels and taxes overall, so a version of ICR where students bear an increasing amount of the cost of education fits well into their world view.

However, opponents and supporters of ICR do not fall neatly on either side of the left-wing or right-wing political spectrum. The camp of ICR supporters consists of economists seeking market efficiencies but also includes, according to Johnstone (2001), “lots of financial aid folks who don’t care a fig for the privatization of higher education, but who simply see more and more students struggling with high student debt loads and uneven income prospects.”<sup>76</sup>

The ICR debate, according to Usher (2005), is “long on passion and short on analysis,” the arguments for and against it “based on program features that are either not intrinsic to an ICR program or which could easily be present in any type of loan repayment system.”<sup>77</sup> Indeed, the rising tuition rates and shifting cost burdens that we currently observe in Canada have occurred despite a student loan repayment framework that is, for the most part, based on an MSR approach.

Moreover, the argument over the relative merits of MSR systems versus ICR systems is largely theoretical. In reality, most large-scale student loan repayment schemes contain elements of both systems. A closer look at the program details of MSR systems throughout the world reveal elements of ICR. On the other hand, existing ICR systems do not generally reflect Friedman’s vision as they contain elements of subsidization. To understand fully the practical applications of MSR and ICR we must look to real-world examples.

### International Examples of ICR

The Yale Tuition Postponement Option is a commonly referenced example of how not to run an ICR program. Alternatively, the Australian system is widely touted as a successful instance of an ICR program in action. Valuable lessons can be learned from taking a closer look at both.

#### *The Yale Tuition Postponement Option*

In 1971, Yale University announced tuition and fee increases. Along with this news came the introduction of the Tuition Postponement Option (TPO), an ICR program wherein students would not have to pay their tuition or fees until after graduation—in effect, a student loan.

The TPO exhibited the two distinguishing characteristics of ICR; the relationship of payment amounts to income level, and a variable term of loan repayment. A maximum duration of 35 years was placed upon the repayment term which

meant that a student who was unable to pay down the entire loan throughout his or her career would have the outstanding balance forgiven at the end of the 35 years. For the duration of the 35 years, borrowers were expected to pay 0.04% of their adjusted gross income for every \$1,000 they had borrowed. A minimum payment was required regardless of income levels to ensure that over the 35 years, at least the principal of the loan would be recovered, if not the accumulated interest.<sup>78</sup> Under the TPO a floating interest rate was charged, that is, the rate was set every six months according to Yale's anticipated cost of administering and financing the program.

The TPO was, by definition, optional. Students could opt out of the repayment plan by paying the amount of deferred fees plus interest accrued prior to graduation. After graduation, the borrower could opt out by paying 150% of the principal amount plus interest. The Yale program was terminated in 1978, its failure largely attributed to complications with collection and to problems of adverse selection. According to Woodhall (2007), "the fact that graduates could choose to 'opt out' of the Yale Plan almost certainly meant that those who expected to become high earners would choose *not* to subsidize their poorer classmates."<sup>79</sup>

### *The Australian Higher Education Contribution Scheme and Higher Education Loan Plan*

Until 1989, Australian PSE students paid virtually no tuition. However, in the late 1980s the increased demand for post-secondary expansion collided with growing public opinion that "having a higher education system financed almost completely from tax revenue was regressive in income distribution terms."<sup>80</sup> The government's response was to shift a portion of PSE costs onto consumers through the introduction of the Higher Education Contribution Scheme (HECS). Under HECS, all PSE students were expected to pay a standardized fee for each year of education.

Mindful that this new approach could negatively impact PSE participation among the economically disadvantaged, developers of the HECS chose an ICR approach wherein student debt was collected through the tax system at different rates dependent upon annual taxable income. In 1996, for instance, graduates earning less than \$27,675 (AUD) would not be required to make an HECS payment. Those earning above that threshold would be required to pay between 3% and 5% of their taxable income.<sup>81</sup>

One salient feature of the HECS was that student borrowers paid a rate of real interest of zero. Usher (2005) refers to this as an interest subsidy where "no real interest is charged, but loans are permitted to grow with inflation so as to remain of constant value in real terms."<sup>82</sup> Therefore, the nominal interest rate charged on HECS debt was only 2.4%, much lower than market-borrowing rates.

Like the Yale example, HECS was characterized by universal coverage—an individual needs-assessment was not required to qualify. However, there was an opt-out provision; students who opted out by paying tuition up front were given a 25% discount on their assessed fee. HECS circumvented the issues of

collection experienced by Yale by using the tax system as a collection agency for student debt. As a result, the HECS system “turned out to be very inexpensive in administration terms.”<sup>83</sup>

According to Chapman (2005), Australian enrolments increased by 50% since the introduction of the program, not only because the HECS system enabled universities to increase their capacity for student intake, but also because it neutralized to some extent the deterrent effect of tuition charges.<sup>84</sup>

In 2005, the Australian student-finance system underwent a number of changes under the new Higher Education Loan Program (HELP). Universities were able to increase their tuition prices up to 25% for programs subsidized under the previous HECS regime. Loans such as those described above are now known as HECS-HELP loans, and are reserved for students in “Commonwealth Supported Places.” An additional support program is available for students paying full fees.<sup>85</sup>

The original intention of the HECS-HELP system was not to shift all of the costs of PSE onto students, but to enter into more of a cost-sharing approach than was available in the previous no-fee system. Furthermore, “the fundamental importance of not erecting financial barriers to participation in higher education for the economically disadvantaged” was a key consideration in the program’s development.<sup>86</sup>

Those who contend that ICR systems create a vehicle for ever-increasing tuition rates may look to the Australian changes of 2005 to support their view. However, it is important to note that other program changes are in place to offset the impacts that tuition increases may have on low-income and risk-averse learners. In 2005, the income threshold for repayment rose considerably “from its 2004 level of about \$26,000 to just over \$36,000 per annum in 2005.”<sup>87</sup> This means that although the overall fee for university attendance may have increased, loan payments are not required of low-income graduates earning significantly higher amounts than under the previous regime.

The HECS-HELP scheme is one of the longest-running ICR programs available for research, and the subject of numerous studies to determine whether it has improved PSE access for students from lower-income backgrounds. According to Chapman (2005), various studies have concluded that the HECS-HELP has had little or no effect on disadvantaged students’ access to PSE.<sup>88</sup> These findings may at first seem discouraging, but not if one takes into account that the studies in question compared two very different systems one in which students had virtually no tuition costs, and another which required students to pay tuition fees and enabled them to graduate with accumulated debt loads of up to \$20,000 (AUD).

Viewed from this perspective, the HECS-HELP program has been remarkably successful, particularly because the proportion of lower-income students studying in Australia has not been affected by the increasing costs that have accompanied the program.

The key determinant of Australia's success is that its program adopts a risk-sharing, not a risk-pooling, approach. Under risk-pooling, as in the Yale example, the risks of default are shared among the borrowing cohort. In the Australian example, the risks of default are more broadly shared (i.e., between the pool of borrowers and the rest of society) so that the risk is essentially subsidized.

### Considering ICR in the Canadian Context

The relative merits of moving toward a full ICR system has been the subject of an ongoing debate in Canada. For example, in 2007 New Brunswick expressed the "need to return to the idea" as part of *Advantage New Brunswick*, the province's strategic review of its PSE system.<sup>89</sup> However, implementation of a full ICR program would require radical changes to the way that CSLP repayments are structured and to how the program is administered. As established elsewhere in this report, administration of the ICR through the Canada Revenue Agency likely represents the most administratively efficient and cost-effective approach.

As noted earlier, a risk-shared approach to ICR is considered more equitable than the risk-pooling envisioned by Friedman and applied in the failed Tuition Postponement Option program at Yale University. Moreover, ICR's successful implementation in Canada would depend on Canada Revenue Agency's willingness to administer the program, and on the government's willingness to provide some level of subsidy.

It is possible that some student organizations and other interest groups could strongly oppose even the suggestion of an ICR system in Canada. However, as Usher (2005) notes "income-contingency is a reasonably good idea." He suggests that most criticisms of ICR "are actually criticisms of negative amortization or tuition hikes that in some instances accompany ICR, rather than criticisms of the concept of income-contingency itself."<sup>90</sup> Usher therefore suggests that the notion of ICR be discarded in favour of a system that incorporates "actual [ICR] program features that appear to be of value" such as: an appropriate and acceptable low-income threshold; a subsidy that can control for the possibility of runaway interest accumulation; and a maximum loan repayment term.

Despite the popularity and acceptability of the ICR idea, Finnie, Usher and Vossensteyn (2004) take the position that MSR schemes need not be discarded in order to improve the system of debt servicing. They argue for "a simple fine tuning and strengthening of the present interest and debt-relief programs (which contain a strong element of income contingency). This would build on existing structures and conventions in a way that similarly adjusts payments to debt burden in an effective manner."<sup>91</sup>

Policy-makers can adjust either of these student loan repayment approaches to their needs. For the most part, the CSLP follows an MSR approach (i.e., a fixed repayment schedule), although it also contains income contingent features accessible to borrowers meeting certain criteria. This hybrid approach is increasingly recognized as the preferred approach for large-scale student loan systems.<sup>92</sup>

## PART IV: REPAYMENT AND THE CANADIAN STUDENT LOANS PROGRAM—RECENT CHANGES

Student loan repayment under the CSLP is primarily a MSR system, supplemented with a number of ICR fail-safes available to borrowers who face repayment challenges and apply for assistance. Although the program's repayment supports changed significantly in 2009, the system's hybrid approach has essentially remained intact.

To recap, under the CSLP students apply for funding and are given an annual amount based on their assessed need. During the study period interest does not accrue on CSLP loans. Although interest does accrue after graduation (or upon leaving study for other reasons), payments are not required for the initial six-month grace period. During this time, the borrower negotiates a consolidation agreement that sets out the terms of repayment for the loan. The standard amortization period is 114 months (10 years less the grace period), although students who are able to pay off their debt more quickly can do so without penalty. These facts hold true for the CSLP both before and after the 2009 changes.

Under the CSLP framework, both before and after the 2009 changes, interest rates can be relatively high, depending upon the prime rate and whether the borrower has agreed to a fixed or floating rate. The CSLP currently applies a floating rate of prime plus 2.5%, and a fixed rate of prime plus 5%. In 2006, students graduating with debt reported an average debt load of \$24,047.<sup>†,93</sup> According to the repayment calculator available on the NSLSC website,<sup>‡</sup> repayment of this amount within 114 months at a fixed interest rate would require a minimum monthly payment of \$321 and over \$12,000 of interest. A student could apply for a bank mortgage of a similar amount and be charged less interest.

Unlike many mortgages, outstanding student debt can be discharged at anytime without penalty. Considerable savings are possible if a borrower pays off their student loan prior to the end of the amortization period. For those unable to do so, tax savings are available. Borrowers in repayment qualify for a 17% tax credit on the interest paid on student loans each year.<sup>94</sup>

As previously discussed, some CSLP borrowers experience the harsh realities of high debt-to-income ratios once they begin repaying. Fortunately, the program's repayment scheme contains income contingent features that can offer some relief to these borrowers. The following sections review the repayment supports in existence prior to 2009, and those established in 2009 under the new Repayment Assistance Plan (RAP).

<sup>†</sup> This figure includes CSLP debt as well as provincial student-loan debt and debt owed to family and financial institutions; therefore not all of the amount would be subject to the CSLP's terms. For simplicity, this discussion uses this figure to calculate debt repayments under different scenarios.

<sup>‡</sup> Available at <https://nslsc.canlearn.ca>

## CANADA STUDENT LOAN REPAYMENT SUPPORTS PRIOR TO 2009

### Interest Relief

Prior to the changes implemented in 2009, a temporary period of interest relief (IR) was available to students experiencing loan repayment difficulties, but who were not yet in default provided they met the gross monthly-income eligibility threshold (as determined by the borrower's family size and monthly repayment amount). For example, a single borrower grossing less than \$2,200 monthly and required to make monthly payments of between \$325 and \$350 would be eligible for interest relief. In this instance, the borrower's monthly payments would have exceeded 17% of her monthly net earnings of \$1,826 (assuming a tax rate of 17%).

However, debt-to-income ratios need not be as high as the one cited in the above example to result in financial hardship. Baum and Saunders (1998) suggest that "10-12% is likely to cause hardship."<sup>95</sup> Therefore, a low-income borrower who did not meet the threshold level defined under the IR program could easily slip into default before being eligible to apply for assistance.

According to Situ (2006), IR was also intended "as a type of insurance to prevent loan aversion due to fear of not being able to repay the loan" designed to "reassure borrowers that, in the possibility of future financial hardship, their student loan obligation [would] not become a burden."<sup>96</sup>

For IR to be effective, it is extremely important that borrowers are aware of the availability of debt-management supports. For example, the IR program could not reasonably provide the insurance function noted by Situ if borrowers and prospective borrowers were unaware of its availability. However, in their analysis of The Canadian Post-Secondary Student Financial Survey, Berger, Motte and Parkin (2007) found that only 9% of respondents felt that they had received enough information about financing their education in general while 34% would have liked more information specifically about loan repayment issues.<sup>97</sup>

Under the previous regime, IR was available for periods of six months. However, borrowers could successfully apply for IR up to five times (for a total of 30 months). Up to an additional 24 months was available for borrowers experiencing prolonged repayment difficulties who had been out of school for five years or more.

The effect of IR was to create a variable amortization period for successful applicants. Because the government paid the interest on the loan for the period during which the borrower was in the IR program, the extended amortization period did not impose any additional interest costs on the borrower, as it most likely would have done under a true ICR system.

## Debt Reduction in Repayment

Students who had exhausted their initial 30 months of IR eligibility could qualify for up to three reductions in the principal amount of their debt, to a maximum of \$26,000. As with IR, debt reduction in repayment (DRR) contained an income-contingent measure: to qualify, the borrower's family income had to fall within the program's maximum allowable level.

## Revision of Terms

Under the revision of terms (RT) stipulation borrowers could reduce their monthly payments (temporarily or permanently) by revising the terms of their consolidation agreement with their lender, with the option of extending the amortization period to a maximum of 14-and-a-half years. RT was available to most borrowers and could be tailored to meet individual financial needs. The borrower, in consultation with the lender, could assess whether their debt-to-income ratio was sufficiently high to warrant a RT. Therefore, although the measure is not directly linked to income, RT can still be viewed as an income-contingent repayment support.

## CANADA STUDENT LOAN REPAYMENT SUPPORTS SINCE 2009

### Introduction of Repayment Assistance Plan, 2009

In August 2009, the Repayment Assistance Plan (RAP) was introduced to replace the IR and DRR program elements of the CSLP (the revision of terms option of up to 14.5 years was left unchanged). The objectives of RAP are as follows:

- to reflect more accurately the capacity of borrowers in financial difficulty to repay their loans by using the single criterion of debt payments-to-income ratio as the basis of assessment;
- to ensure that no payments are required from borrowers with very low incomes;
- to ensure that no borrower is required to make student loan payments above affordable levels; and
- to ensure that no repayment period exceeds 15 years from the latest post-secondary exit date.<sup>98</sup>

These measures were introduced primarily to address the shortcomings of the previous debt management provisions, including "inconsistent and complex eligibility criteria and inadequate assistance"<sup>99</sup> in meeting the needs of borrowers requiring assistance with the repayment of their student loans. A key problem with the previous IR program was its all-or-nothing approach: those who qualified for assistance received benefits; those who were experiencing repayment difficulties but were at the margin of eligibility did not qualify.<sup>100</sup>

Under the RAP, the borrower's repayment period can not extend beyond 15 years. The key feature of the program is the affordability of payments. A borrower is eligible "if their Affordable Payment (AP) is less than their required monthly payment" as described in their consolidation agreement. The assessment used to determine the affordability of a payment is rather complicated, taking into account the borrower's gross family income and size of family, and a minimum income threshold.<sup>101</sup> For instance, a single borrower earning a monthly income of \$1,684 or less would not be required to make a payment.<sup>102</sup> Unlike the all-or-nothing approach of the previous interest relief program, the RAP "uses a sliding scale with fourteen cut-off points, and caps the level of affordable payment to provide some relief to not only low-income earners, but also middle and higher-income earners."<sup>103</sup> Payments are capped at 20% of an eligible borrower's income.<sup>104</sup>

The RAP consists of two repayment stages. During stage one, which occurs during the first five years following graduation, any payments made by the borrower are applied toward the principal of the loan, while the federal government pays for any interest that the affordable payment amount does not cover.<sup>105</sup> A second stage is initiated after five years of assistance, or if a borrower has been in repayment for over 10 years. Affordable payments continue to be made, however the federal government covers interest charges and a portion of the principal amount to ensure that the loan is completely discharged within 15 years of the borrower having exited studies.<sup>106</sup>

A second RAP program is available for borrowers with permanent disabilities (RAP-PD), in recognition that these individuals oftentimes face more challenging circumstances than other borrowers. Those eligible for RAP-PD may have their loans completely discharged within 10 years, and can deduct allowable medical and other disability-related expenses from the gross family-income amount applied in the calculation of affordable payments.<sup>107</sup>

A serious flaw of the pre- and post-2009 repayment assistance regimes is the exclusion of borrowers who have already defaulted on their student loans.<sup>108</sup> Borrowers who are most likely to be in default are those who have experienced difficulties in repayment, precisely the group that the debt management provisions are intended to serve. Another weakness of both regimes is that qualification is borrower initiated. Borrowers in repayment must apply to benefit from these programs; they do not automatically qualify, as would borrowers under a true universal ICR program such as the HECS-HELP. Therefore it is extremely important that borrowers are well-informed about the repayment assistance available to them through the RAP and provincial programs. Borrowers who lack such information and are experiencing repayment difficulties may slip into default, and thus become ineligible for assistance.

## INFORMATION SUPPORTING STUDENT LOANS PROGRAMS

Canadians generally recognize that individuals who have some post-secondary education are more likely to achieve labour-market success. As Corak, Lipps and Zhao (2003) note "a very high proportion of Canadians from all income

backgrounds view higher education as the pathway to higher earnings and over four-fifths of families expect their children to attend a post-secondary institution."<sup>109</sup> A primary concern of researchers and policy-makers is finding ways to increase PSE participation among low-income students and other groups traditionally under-represented, thus ensuring equity of opportunity for all Canadians. Student financial aid is considered to be a pillar in efforts to improve access, however the success of student loan programs depends to a large extent on whether borrowers are properly informed about their availability. Widening access to information about student aid is therefore critical to improving access to PSE.

The internet is the preferred vehicle for widening access to information about student loans. When the CSLP shifted to a regime of direct loans in 2000, it launched a public information campaign which included the creation of two websites, the National Student Loans Service Centre ([www.nslsc.canlearn.ca](http://www.nslsc.canlearn.ca)) and a more interactive site called CanLearn ([www.canlearn.ca](http://www.canlearn.ca)) Together, these websites offer a wealth of information for students, prospective borrowers and borrowers in repayment.

The National Student Loans Service Centre website features online tools to facilitate student loan repayment, enabling users to check repayment status, apply for interest relief, and to update their address and income information. CanLearn provides a wealth of information about PSE in Canada; prospective students can learn more about their PSE options using the search tools that link them to various PSE institutions and programs. The website also provides information about student financial aid and interactive debt management advice through tools such as loan repayment calculators, education-cost and budgeting calculators.

Yet as Junor and Usher (2002) have observed "despite all the available government brochures, publications, and websites, the student loan system remains a mystery to many students."<sup>110</sup> Moreover, there is evidence that, in previous years "information on CSLP program changes and assistance [was] poorly communicated to students."<sup>111</sup> The introduction of the RAP in 2009 provides a new opportunity to evaluate whether there have been any improvements in that regard. However, information regarding the effectiveness of the RAP's information campaigns is not yet available.

Overall, the student loans framework has been subject to frequent changes, adding complexity that can affect the accessibility and transparency of student-finance information. This may have a disproportionate impact where low-income students are concerned. As de Broucker (2005) notes, youth from low-income and less-educated families "are particularly likely to be at a disadvantage when it comes to having access to and understanding information sources and the wide range of opportunities they may offer." He suggests that "there is no better place than school to ensure that all students have access to the appropriate information and guidance services."<sup>112</sup> Awareness about student finance and loan repayment needs to be raised among students long before they leave high school. This may be the key to ensuring that low-income students receive accurate and useful information.

Yet as Usher (2005) concludes, “when families look for information about post-secondary education in general or student assistance in particular, they are most likely to turn first to family and friends ... rather than ‘official’ sources of information.”<sup>113</sup> Information about the CSLP gained primarily through word-of-mouth is great cause for concern, since inaccurate advice from family and friends can serve to perpetuate myths and misperceptions about PSE that could discourage participation.

Evidence has shown that low-income Canadians underestimate the value of a university education, but also overestimate its costs.<sup>114</sup> This type of misinformation can lead to perceptions of price constraints, a barrier that occurs when “the price of education is considered too high for the expected return.”<sup>115</sup> As the Ontario Undergraduate Student Alliance (2009) notes, “if students were aware of repayment methods that allowed them to escape the burden of massive debt levels, surely more would be willing to see their degree through to completion.”<sup>116</sup>

Further, an Ekos Research Associates study conducted in 2006 for Human Resources and Social Development Canada (HRSDC) revealed that the unmet information needs of at-risk borrowers can result in loan default.<sup>5, 117</sup> Ekos found that issues related to timing are most important to at-risk borrowers treading dangerously close to default. If they are unaware of the status of their loan, of missed payments, or of the availability of interest relief, they may be unable to avoid default. Ekos concluded that better access to information could significantly ameliorate this situation: “with more information, borrowers feel that they will be in a position to take more ownership of their actions during their student loan.” It also found that while borrowers acknowledge “that the CSLP will not be able to solve all their financial problems, [they] are eager to gain some semblance of control over their personal finances.”<sup>118</sup>

Clearly, better and more accessible information is needed to dispel fears and myths so as to encourage participation. Moreover, it is equally important that parents are as well-versed in student finance as are their children. As Berger and Baldwin (2009) assert, “the opportunity to communicate directly with parents who, because of their financial situation, may see post-secondary education as something that is not attainable for their children, should not be missed.”<sup>119</sup>

In its formative evaluation of the CSLP (2004), HRSDC made a number of suggestions to improve the program’s informational supports including:

- visits to high schools by CSLP or provincial loan program staff to talk to senior students about the types of assistance available, eligibility criteria, procedures and repayment responsibilities;
- academic counselors in both high schools and post-secondary institutions who are better informed about government assistance; and,
- post-program repayment information sessions for students entering the repayment phase of the loan cycle.<sup>120</sup>

<sup>5</sup> The research was intended to inform strategies to increase awareness of the CSLP’s debt management measures, and ultimately to decrease the default rate.

However, another key challenge to providing clear and accurate information to prospective or current student loan clients is to take into account the significant variation among provincial student loan programs. As Berger (2009) notes, “provincial governments establish their own frameworks for tuition and fees and offer their own student aid provisions.”<sup>121</sup> A number of provinces offer loan remission or forgiveness programs for qualifying graduates. Manitoba, New Brunswick, Saskatchewan and Nova Scotia offer tuition rebates through the tax system in an effort to retain graduates. These various provincial programs can affect student loan repayment calculations, but it is unclear to what extent provincial programs are taken into account in the tools and calculators available at the CanLearn website.

Moreover, there are many borrowers in repayment who must service more than one student debt, either because they have outstanding loans from the era when financial institutions managed repayment, because they live in a province where the administration of loan repayment has not been integrated, or because they borrowed to attend programs at both public and private institutions. Providing clear information about the management of student debt of this complexity can be excessively complicated—regardless of how well-designed any one student loan management website may be.

## PART V: CONCLUSIONS AND NEXT STEPS

Student loan repayment mechanisms in Canada are primarily characterized by a mortgage-style repayment (MSR) scheme. For the vast majority of borrowers who do not experience any difficulty in repayment, as measured by their debt-to-income ratios, these systems work well. However, a number of income contingent repayment (ICR) measures have been put in place to ensure that student debt does not become crippling for new graduates experiencing repayment difficulties. With the introduction of an incremental scale for the assessment of affordable payments, the RAP is an improvement upon the previous Interest Relief program, under which all those who earned above a threshold were required to make their full scheduled payment.

Data are not yet available to measure whether implementation of the RAP will affect borrowers’ default rates or perceptions of repayment difficulty. However, Berger (2009) notes that the new measures align with a type of program that experts have promoted, namely a hybrid that combines features of both ICR and MSR methods.<sup>122</sup> Moreover, the Ontario Undergraduate Student Alliance (2009) has recommended the harmonization of Ontario’s debt-repayment program with the RAP. It notes that, among other benefits, the “RAP is progressive and unique as it allows all payments to be applied to the principle [sic] first, and then to the interest second. If any interest is not covered by the affordable payment, it is automatically forgiven by the government.”<sup>123</sup>

One obvious advantage of the CLSP’s hybrid repayment scheme is its flexibility. It allows for small changes to the calculations of program elements, such as affordable payments and income threshold, which can significantly affect

borrowers' ability to manage their student debt. Alleviating the debt-repayment burden for graduates with high debt-to-income ratios does not require a revolution in Canadian student aid.

However, further efforts to simplify the CSLP are necessary to reach the elusive goal of "one student, one loan."<sup>124</sup> The delivery of student financial aid remains highly complex, particularly in provinces that have yet to integrate their provincial loan regimes with the CSLP. The inherent complexity of the CSLP and provincial variations in loan regimes pose a key challenge to providing clear, accurate information to students and their parents.

As governments across Canada recover from the deficit budgets incurred in the latest recession "we can anticipate a period of constraints in public spending" and the possibility of tuition increases in many provinces.<sup>125</sup> Berger (2009) notes that student aid funding may also be entering a precarious period.<sup>126</sup> Enhancing the financial literacy of all Canadians is critical, more so than before, particularly with regard to saving for post-secondary educations that are increasingly costly and necessary. Student financial assistance in Canada is multi-faceted and complex, but recent changes to the CSLP have the potential to ensure that student loan repayments are more manageable for all.

Further simplifications and broader public awareness may ultimately accomplish the CSLP's objective: to promote equitable access to PSE, particularly for students from lower-income families. To be successful, the CSLP must find ways to assure potential students that their fears about unmanageable student debt can be appropriately addressed and should not deter them from participation in PSE.

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