The Importance of "Choice Architecture" for Student Loan Repayment Decisions & Outcomes[*]

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The term "choice architecture" applies to a specific decision and encompasses the ways in which different options could be presented to a decision-maker.[i] The choice architecture of student loan repayment could include the number and order of repayment plans shown to a borrower, any information intended to help borrowers compare and contrast their options, and the "default" or repayment plan that is selected when the borrower fails to actively indicate their choice.

Evidence related to student loan repayment

Changes to the ways in which student borrowers are informed of their options may affect repayment plan choice and borrowers' success in paying down their loans:

1. Evidence from an information experiment that presented students with hypothetical loan repayment scenarios suggests that the **framing of repayment plan options** may affect whether borrowers understand the costs and benefits of choosing the "standard" (fixed amount, 10-year) repayment plan compared to an income-driven repayment (IDR) plan.[ii]
    - When IDR is framed as insurance against unaffordable loan payments (when earnings are low), students are significantly more likely to indicate they would choose IDR. Conversely, when potential costs of IDR (longer repayment period and negative amortization) are emphasized, students are less likely to indicate a preference for IDR.
    - Framing IDR as insurance has larger effects on:
        - Students who expect to have low or no earnings when they leave college.
        - Black, Hispanic, and Native students.
    - ***Implications*: comparisons of loan repayment plans that do not explicitly incorporate the risk of unemployment or income shocks could lead to underutilization among borrowers who could benefit the most from the insurance offered by IDR.**

2. Evidence from a lab experiment that presented students with different versions of the existing Student Loan Exit Counseling website suggests that **many borrowers who would likely benefit from IDR are "defaulted" into the standard 10-year repayment plan** because they do not make an active choice when entering repayment.[iii]
    - In the experiment, changing the "default" repayment plan – or plan that a student is placed in if they do not actively choose a different option – to REPAYE led to sizeable increases in IDR take-up.
    - In contrast, when the standard plan was the default choice, **providing additional information** on post-college earnings prospects, **simplifying the language** used to describe different options, or **reducing complexity** by only offering a limited subset of existing repayment plans **had little to no effect on IDR choice**.

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- While the study does not examine whether effects vary by student demographics, 61 percent of participants in the study were Black.
- ***Implications*: Making IDR the default repayment plan would lead to larger increases in IDR take-up than providing additional information on the benefits of IDR or simplifying repayment options.**

3. In partnership with a loan servicer, researchers conducted a field experiment in which borrowers were randomly assigned to receive an IDR application that was pre-filled.[iv] Results suggest that **reducing the cost and complexity involved with applying for IDR** by providing assistance with the application can increase IDR take-up for eligible borrowers.
   - Borrowers that received pre-filled forms were significantly more likely to switch to an IDR plan and, likely as a result, had lower loan payments.
   - These borrowers also were significantly less likely to default.
   - ***Implications*: simplifying the IDR application process and/or providing assistance with the process could increase IDR take-up and improve financial wellbeing.**

<u>Other evidence</u>:

Various dimensions of choice architecture also play a role in student loan *borrowing* decisions. Researchers have shown that the framing and labeling of student loans altered survey respondents reported willingness to borrow, with larger effects for Black and Hispanic high school seniors.[v] Evidence from a field experiment shows that loan packaging significantly increased borrowing and short-run educational attainment, even without any changes to the steps required to access loans.[vi]

Finally, there is robust evidence that default options matter for decisions along a variety of other dimensions, from retirement savings contributions[vii], to health insurance choice[viii], and even for the decision to be an organ donor.[ix] When individuals are required to opt-in to an employer-sponsored retirement savings plan, they are significantly less likely to make any contributions (and thus, save less) than when participation is the default. Automatic enrollment in a savings plan may especially benefit those who are less financially literate and those who have less experience making such decisions.

<u>Conclusions</u>:

While there are many relevant aspects of the choice architecture of student loan repayment options, existing research evidence suggests three promising avenues for increasing IDR take-up: making students aware of the insurance value of IDR, making IDR the default repayment plan, and assisting borrowers with the IDR application process. Given existing research on the importance of default options in other contexts, the choice of the default repayment plan is likely the most consequential. At present, borrowers who do not make an active choice are automatically placed in the standard plan. Thus, the key question is whether such borrowers would be better off in IDR. This is a difficult question to answer without additional data on the characteristics and outcomes of borrowers who do and do not actively choose a repayment option. However, to the extent that borrowers who leave school without earning a degree are less likely to complete the formal exit counseling process and, thus, do not actively choose their repayment plan, automatically placing such borrowers in IDR could help reduce their risk of delinquency and default in the short run. In the longer run, whether such borrowers benefit from IDR will depend on how easy it is to remain on IDR and the specific parameters of the repayment plan.

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[ii] Abraham, K.G., Filiz-Ozbay, E., Ozbay, E.Y. & Turner, L.J., 2020. "Framing effects, earnings expectations, and the design of student loan repayment schemes," *Journal of Public Economics* 183: 104067.

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[iv] Mueller, H.M. & Yannelis, C., 2019. "Reducing Barriers to Enrollment in Federal Student Loan Repayment Plans." Working Paper.

[v] Evans, B.J., Boatman, A. & Soliz, A. 2019. "Framing and labeling effects in preferences for borrowing for college: An experimental analysis," *Research in Higher Education* 60(4): 438-457.

[vi] Marx, B.M. & Turner, L.J. 2019. 2019. "Student Loan Nudges: Experimental Evidence on Borrowing and Educational Attainment," *American Economic Journal: Economic Policy* 11(2): 108-141.

[vii] Chetty, R., Friedman, J.N., Leth-Petersen S., Nielsen , T.H., & Olsen, T. 2014. "Active vs. passive decisions and crowd-out in retirement savings accounts: Evidence from Denmark," *Quarterly Journal of Economics* 129(3): 1141-1219.

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[viii] Bhargava, S., Loewenstein, G., & Sydnor, G. 2017. "Choose to lose: Health plan choices from a menu with dominated option," *Quarterly Journal of Economics* 132(3): 1319-1372.

[ix] Johnson, E. J. & Goldstein, D. 2003. "Do defaults save lives?" *Science* 302(5649): 1338-133.