COHORT DEFAULT RATES IN CONTEXT

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Burgeoning student loan debt indicates problems not only for the country's borrowers but also for our postsecondary system. The rise in student loan defaults signifies a rise in institutional cohort default rates (CDRs)—a measure of accountability that informs the government and the general public how well an institution prepares its students for loan repayment. Like any institutional measure, CDRs support explanations or assumptions about institutional effectiveness and responsiveness.

The issues of student debt and CDRs are of particular concern for Minority-Serving Institutions (MSIs), which have a legacy of providing increased access to some of the nation's most underserved students. Students who enroll at MSIs are more often low-income, first-generation, and underprepared—all student characteristics that indicate a greater likelihood of loan default (Fletcher 2010; McMillon 2004; Volkwein and Cabrera 1998; Woo 2002). Additionally, many MSIs are located in regions with high unemployment rates; as such, some MSIs have higher than average CDRs. A number of MSIs are working to develop and implement sound solutions to manage default, particularly by way of financial literacy initiatives (IHEP 2008, 2009, 2010; Looney 2011; USA Funds 2011).

A number of studies explore the individual characteristics and implications of student loan default, but few address how postsecondary institutions and their practices may shape borrower behavior. Students who default may do so for a variety of reasons including misinformation, lack of awareness of forbearance and/or deferment options, and other tools to manage loan use. Institutions, MSIs and non-MSIs alike, have an obligation to provide the necessary resources and information to ensure that students are better equipped to manage loans. Current institutional strategies and solutions related to managing and preventing default are often varied and may not target student behavior related to loan use.

This brief seeks to address the approaches that institutions may employ to reduce or manage a CDR—with a particular emphasis on MSIs. In highlighting these common approaches, this brief hopes to make a stronger case for financial literacy strategies as a solution for institutions looking to increase student completion and reduce default rates.

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What Is a Cohort Default Rate?

Often default is characterized at the institutional level as an aggregate of the number of defaults to those who borrowed and expressed as a cohort default rate (CDR). Default rates tell a story about the types of student enrolled, available institutional resources, and overall institutional responsiveness and processes. An institution's CDR is also influenced by environmental factors and local conditions such as unemployment (**SEE BOX** *Regional and State Effects of Default and Unemployment*).

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A CDR is the percentage of an institution's borrowers who enter repayment on the Federal Family Education Loan (FFEL) or Federal Direct Loan (FDLP) program during a specific federal fiscal year. Nationally, CDRs average around 9 percent and have steadily increased since 2005. Current default calculations report on loan defaults over two and three consecutive federal fiscal years. By 2014, the two-year window will no longer exist and only the three-year rate will remain. This formula change will capture more consecutive defaults and is estimated to increase the national default rate to roughly 12 percent by 2014. The new formulation significantly increases institutional CDRs across all institutional types, and specific increases of 93 percent for for-profits, 63 percent for public two-year institutions, and 70 percent for private four-year institutions are expected (Chitty 2010).

The magnitude of a CDR determines whether an institution will receive sanctions or benefits that affect its students. Institutions with low CDRs receive certain benefits related to disbursement of student aid. Institutions with high CDRs risk losing participation in federal Title IV programs such as the Pell grant—a financial support for eligible low-income students. If the CDR is less than 15 percent, institutions may opt to deliver Stafford or PLUS loans in a single disbursement rather than in installments. Additionally, these institutions are not obligated to delay first disbursements of Stafford loans to first-year, first-time borrowers by 30 days. Institutions with consecutive CDRs greater than or equal to 25 percent or greater than 40 percent may lose eligibility for Title IV programs, specifically the federal Pell Grant and Federal Direct Loan programs. Additionally, the Higher Education Opportunity Act (HEOA) of 2008 requires institutions with a three-year CDR that is greater than or equal to 30 percent for the first-time to develop a default prevention plan to be submitted to the U.S. Department of Education. Given the anticipated rise in defaults, the federal government will raise the CDR statutory threshold in 2012 from 25 to 30 percent for receiving sanctions and potential loss of Title IV status.

Understandably, an institution's goal is to have as few defaults as possible. Often an institution with a low CDR is viewed as one that provides the appropriate resources and information on repayment options, offers alternative financial aid options, and educates students on the long-term effects of default. Institutions with a high CDR may not be adequately educating and supporting their borrowers. Institutions with a high CDR also typically have lower graduation and retention rates. When considering this, students are not repaying their loans or receiving any return on their investment due to a failure to complete.

Minority-Serving Institutions (MSIs) and Default

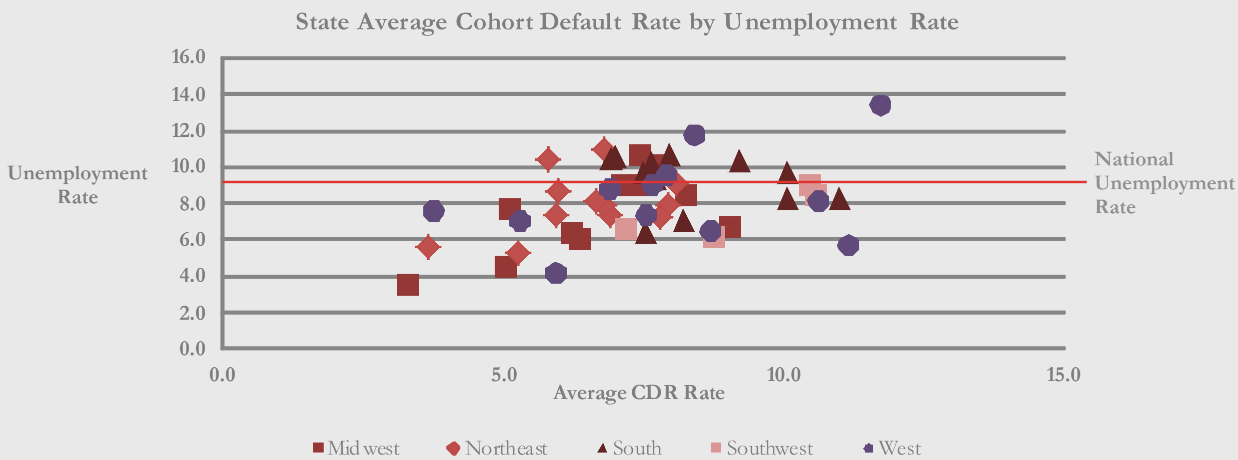
Prior to 1998, certain MSIs such as Historically Black Colleges and Universities (HBCUs) and select Tribal Colleges and Universities (TCUs) were exempt from receiving sanctions for high CDRs. This exemption expired as part of an amendment to the Higher Education Act of 1965. At that time, a number of MSIs faced a great challenge to reduce institutional CDRs in order to remain eligible in federal financial aid programs (Title IV program) (Dillon and Smiles 2010; U.S. General Accounting Office 1993, 1998). Minority colleges and universities are on the verge of yet another CDR-driven crisis: Forthcoming changes to CDR formulations are expected to nearly double current default rates by the year 2014 (Chitty 2010). The reformulation jeopardizes eligibility for students enrolled at MSIs and similar institutions to receive Title IV supports such as the Pell grant and other federal financial aid.

Solutions for Managing CDRs

The default rate process is often reactionary—many institutions do not start addressing student default and borrower behaviors until rates reach an unacceptable level. Default rates are released annually and follow two cycles: (1) Draft and (2) official. A draft CDR does

Regional and State Effects of Default and Unemployment

Understanding the regional and state implications of unemployment and default may help institutions better target policies and programs to enhance financial literacy and student borrowing behavior. For institutions located in high-unemployment states, institutional efforts should concentrate not only on retention but also on degree offerings and local industries. As evidenced in previous work, student default is related to incongruence between degree programs and job availabilities (McMillon 2004). The likelihood of default increases with unemployment rates. With limited to no job opportunities, borrowers are more likely to struggle to make repayments in lieu of covering necessary day-to-day, living expenses. This situation is only slated to get worse should the economy continue to decline and loan use increase.



Source: Bureau of Labor Statistics, Integrated Postsecondary Education Data System, NSDLS 2011

States with higher default and unemployment rates tend to be based in the southern, western, and southwestern regions: All parts of the country experiencing large growth in minority populations—a demographic more likely to default. These regions also tend to have the highest concentration of MSIs. States with high CDRs and unemployment—Arizona, Florida, Nevada, and Texas—include a large number of Hispanic Serving Institutions and Historically Black Colleges and Universities. Conversely, three of the low CDR states—Montana, North Dakota, and South Dakota—have large populations of Tribal Colleges and Universities; the only Minority-Serving Institution designation with a small number of institutions that participate in the Federal Direct Loan Program and the Federal Family Education Loan programs.

not warrant sanctions or benefits; rather, it serves as the basis for an institution's official CDR. Institutions with a high default rate may employ a series of challenges and appeals to avoid sanctions (**SEE APPENDIX** *Cohort Default Rate Challenges and Appeals*). Institutions interested in challenging a draft CDR have about six months before official default rates are released (September). During the draft phase, an institution should review its Loan Record Detail Report (LRDR) for discrepancies or inaccuracies in the data used to calculate the draft CDR.

Institutions with high default rates may commonly use the economically disadvantaged appeal and the participation rate index appeal to avoid sanctions. Both appeals address topical characteristics: Number of low-income students served and number of overall borrowers. Appeals and challenges, if successful, provide a temporary benefit for the institution but not the students. Successful appeals may change an institution's CDR or sanction status but fail to change student behaviors and indicators of default. Additionally, the appeals process does not directly fit within broader institutional objectives such as retention and completion.

Financial literacy programs and practices, conversely, are a proactive approach to managing an institution's default rate and attempt to directly address individual student behavior and eventual completion (Looney 2011). Often such initiatives are embedded in successful retention-driven practices and programs, with the recognition that students who fail to complete college are likely to default on their loans (Cunningham and Kienzl 2011; McMillon 2004).

CONCLUSION

Although a number of factors contribute to an institution's CDR, institutional practices and programs can be instrumental in mitigating default and improving borrower behavior. Unfortunately, available solutions to managing CDRs—in the form of appeals and challenges—only touch on institutional reporting and fail to address student behavior. Institutions looking to lower default must first address barriers to completion, as students who drop out or stop out of college are more likely to default on their loan payment. Financial literacy and education to improve student understanding of loan use should be a part of such initiatives (Looney 2011). Minority-Serving Institutions, in particular, can serve as valuable players in such initiatives and policy conversations, given the types of students they serve and the economic conditions of the communities where they are based.

APPENDIX: COHORT DEFAULT RATE CHALLENGES AND APPEALS:

Incorrect Data Challenge: All institutions, including those with a CDR above the statutory threshold, may challenge their most recent draft CDR. In this appeal, an LRDR contains inaccurate data if (1) a borrower's data were incorrectly reported in the draft cohort default rate calculation, (2) a borrower was incorrectly included in the draft CDR calculation, and/or (3) a borrower was incorrectly excluded from the draft CDR. A successful challenge may change the institution's default and affect its benefits or sanctions status.

Participation Rate Index Challenge: An institution will not receive a sanction based on its CDR if its participation rate index (number of borrowers) is 0.0375 or less (for a sanction based on three consecutive cohort default rates of 25 percent or greater) or 0.06015 or less (for a sanction based on one cohort default rate over 40 percent). An institution may submit a participation rate index challenge for either the most recent draft CDR or for either of the two most recent official CDRs, depending on the type of potential sanction.

Uncorrected Data Adjustment: This request is to be submitted to the Default Prevention and Management (DPM) office to ensure that a school's official CDR reflects changes that were correctly agreed to as a result of an incorrect data challenge submitted by the institution after the draft CDRS. Successful adjustments may raise, lower, or maintain the reported CDR.

New Data Adjustment: This adjustment allows an institution to challenge the precision of "new data" included in the institution's most recent official CDR. New data are loan data reported to the NSLDS that change during the period between the calculation of the draft and official CDRs.

Erroneous Data Appeal: This appeal asserts that due to "new data" and/or "disputed data" included in the official cohort default rate calculation, an institution's official CDR rate is wrong. Disputed data occur when an institution submitted an incorrect data challenge allegation; the data manager for the loan disagreed with the incorrect data challenge allegation; the institution believed the data manager was incorrect; and the same alleged error exists in the institution's official CDR.

Loan Servicing Appeal: This appeal alleges that an institution's official cohort default rate includes defaulted FFELs or William D. Ford Federal Direct Loans that are considered improperly serviced for cohort default rate purposes. If a CDR includes a defaulted loan that was improperly serviced, the DPM will remove that loan from the official calculation, which may lower the rate or leave it unchanged.

Economically Disadvantaged Appeal: This appeal asserts that an institution should not be subject to sanction because it has a large number of low-income students. Two types of economically disadvantaged appeals exist: An appeal based on the institution's low-income rate and placement rate and an appeal based on low-income rate and completion rate. In both appeals, the institution's low-income enrollment rate must be two-thirds or more. For non-degree-granting institutions, the placement rate (students employed upon completion) should be 44 percent or more; for degree-granting institutions, the completion rate should be 70 percent or more.

Participation Rate Index Appeal: This appeal alleges that the number of students obtaining loans is low compared to the number of regular students enrolled. If successful, the institution will avoid sanction.

Average Rates Appeal: An institution may apply this appeal if it is facing a sanction based on three consecutive official CDRs of 25 percent or more and at least two of the official CDRs are average rates that would have been less than 25 percent.

Thirty-or-Fewer Borrowers Appeal: If a combined total of thirty or fewer borrowers entered repayment in the three most recent cohort fiscal years use to calculate a CDR, the institution will not be subject to a sanction.

Source: U.S. Department of Education, 2011a.

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