



Behind the Numbers: Making Sense of Cohort Default Rates

December 2013

Prepared by TG Research and Analytical Services

Table of Contents

DEFINING THE CDR	2
LIFE OF THE LOAN	3
In-School	3
Grace Period	3
Repayment	3
Delinquency	4
Deferment	4
Forbearance	4
Default	4
Rehabilitation	5
BRIEF HISTORY OF CDRS	5
CONSEQUENCES OF HIGH CDRS	6
BENEFITS OF EXCEPTIONALLY LOW CDRS	7
PATTERNS IN DELINQUENCY AND DEFAULT	7
APPENDIX	13
FACTORS ASSOCIATED WITH DEFAULT	14
College Variables	14
Background Variables	15
The Debt	15
Institutional Variables	16
Post-College Variables	16

Behind the Numbers: Making Sense of Cohort Default Rates

DECEMBER 2013

In recent years, national student loan debt has risen to unprecedented levels. Both individually and in the aggregate, students borrow more for postsecondary education today than ever before. As college completion rates remain low and jobs and earnings prospects are less than stellar even for those who do graduate, this increase in borrowing coincides with an increase in student loan delinquency and default. Research suggests that of those students who graduate with debt, over 40 percent will have delinquent and/or defaulted loans within five years of graduation.¹ Even if this rate remains constant, rising college costs and a growing number of students who have trouble repaying their loans will place increasing pressure on colleges and universities to take action and provide repayment support.

Institutions have a great deal at stake in this trend and its impact on their campuses, as this phenomenon presents both a threat and an opportunity. High cohort default rates (CDRs) can harm an institution's reputation and even expose it to federal sanctions, both of which can irreparably damage the institution's ability to recruit and serve students in accordance with its mission. On the other hand, an institution that manages its default rates stays clear of CDR-based sanctions and stands out relative to its peers, enhancing its reputation and demonstrating the institution's value to prospective students, alumni, policymakers, accreditors, and college rating publishers.

For many institutions, achieving low rates requires a commitment to proactive policies designed around the goal of delinquency and default reduction. However, developing effective default prevention strategies is becoming increasingly difficult. Rules and regulations are proliferating, more students are financing their education, borrowers are being monitored over a longer timeframe, and national trends consistently point to higher rates of delinquency and default. Creating and implementing policies that can effectively meet these challenges requires institutional commitment and expertise, which must begin with a detailed understanding of student borrowing, loan delinquency and default, and the federal oversight mechanisms that regulate them.

This guide is intended as a primer on federal student loan CDRs for postsecondary school administrators and other parties who want to learn more about the rates and patterns of repayment. It provides an introduction to CDRs, including their history and importance for borrowers and schools; the basic structure of the life of a student loan; federal policies and regulations that establish the relationship between a school and its borrowers; and delinquency rate dynamics.² In addition, the Appendix provides a review of prior research on factors associated with default.

DEFINING THE CDR

In its most generalized form, a cohort default rate (CDR) is the percentage of borrowers who enter repayment on certain federal student loan(s) within a given fiscal year, and who subsequently default within a certain time period (known as the "cohort default period"). An institution's CDR is calculated as a simple fraction: the numerator is the number of the institution's borrowers who default within the cohort default period and the denominator is the total number of the institution's borrowers who entered repayment within a given federal

fiscal year. This fraction is actually one of two formulas used to calculate an institution's CDR, but that will be discussed in later paragraphs.³

$$\text{CDR} = \frac{\text{NUMBER OF THE INSTITUTION'S BORROWERS WHO DEFAULTED WITHIN THE COHORT DEFAULT PERIOD}}{\text{NUMBER OF THE INSTITUTION'S BORROWERS WHO ENTERED REPAYMENT WITHIN A GIVEN FEDERAL FISCAL YEAR}} \times 100$$

- ¹ Cunningham, A.F. & Kienzl, G.S. (2011). *Delinquency: The Untold Story of Student Loan Borrowing*. Washington, D.C.: Institute for Higher Education Policy.
- ² This document is not intended to be an exhaustive guide for institutional actors navigating the complex landscape of federal student loans. Those who require highly detailed descriptions of regulations, calculations, legal obligations, and other definitions, should consult the Department of Education's Information for Financial Aid Professionals (IFAP) and Default Management websites, particularly the comprehensive *Cohort Default Rate Guide*, which can be found at <http://ifap.ed.gov/DefaultManagement/CDRGuideMaster.html>.
- ³ Borrowers of Federal Stafford loans (made under the Federal Family Education Loan Program, or FFELP) as well as Federal Direct Subsidized and Unsubsidized loans (made under the Federal Direct Loan Program, or FDLP) are included in the rate, but borrowers of loans made under the various PLUS programs, Federal Insured Student Loans, and Federal Perkins Loans are not included (although the Federal Perkins Loan Program has its own CDR calculation). Consolidation loans may also affect the CDR if the underlying loans were made from these programs.

2-year CDR	3-year CDR
DEFAULT October 1, 2009 – September 30, 2011	DEFAULT October 1, 2009 – September 30, 2012
REPAYMENT October 1, 2009 – September 30, 2010	REPAYMENT October 1, 2009 – September 30, 2010

Cohort default rates are measured over a 3-year cohort default period (and were previously measured over a 2-year period). Both the cohort default period and the cohort itself are based on the federal fiscal year, which begins each October 1 and ends the following September 30, with the fiscal year (FY) taking the name of the calendar year in which it ends. Thus, the formula for the 3-year CDR for FY 2010 has as its denominator all of a school's borrowers of certain federal loans

who entered repayment between October 1, 2009, and September 30, 2010. The numerator is the number of borrowers who default on those loans between October 1, 2009, and September 30, 2012. In September 2014, the Department of Education (ED) will publish official 3-year CDRs for FY 2011. At that time, three years of 3-year CDRs will be available, and the 2-year CDR methodology that ED had utilized previously will be completely phased out.

While the CDR for the majority of institutions is the simple fraction of borrowers with defaulted loans over all borrowers in repayment, for schools with fewer than 30 borrowers entering repayment in a given fiscal year, ED utilizes a formula known as the average rate. This formula takes into account three consecutive years of borrower data. Schools with fewer than 30 borrowers should be aware of the special calculations, rules, and appeals processes that apply to their circumstances.

LIFE OF THE LOAN

The typical student loan can go through a number of phases over the course of its lifecycle, including the in-school period, grace period, and repayment; repayment may include periods of delinquency, deferment, forbearance, and in some cases, default. Understanding the chronology of these phases and how a loan progresses from one to another is crucial for a full understanding of loan default and, by extension, the formation of a CDR.

In-School

Schools originate all federal student loans. Per federal rules, a school must provide a student borrower with a one-time entrance counseling session prior to the first disbursement of his or her first Direct subsidized or unsubsidized student loan. This loan counseling is often delivered in the form of an online course developed by ED but may be provided in person by the school or a third-party provider. A student borrower must also be free to accept or reject any amount of federal student loan funding for which he or she is eligible. A student borrower agrees to repay federal loan dollars by signing a Master Promissory Note, which defines the legal rights and responsibilities of both the borrower and the loan holder. For subsequent loans, the borrower will not generally sign another promissory note but will receive disclosure statements from the loan holder instead. Despite both the entrance counseling and the promissory note, research shows that student borrowers frequently lack a basic understanding of key aspects of their loans, like interest rates and repayment plans. This may be largely an issue of timing, as students generally must make their borrowing decisions during the first week of classes while trying to acclimate themselves and navigate their new surroundings.

Grace Period

Once a student borrower graduates, drops below half-time enrollment, or withdraws, his or her school is required to provide exit loan counseling. Exit counseling provides important information the borrower needs to prepare to repay his or her federal student loans. At this stage, the borrower's federal loans enter a 6-month grace period during which he or she is not required to make payments on the loan principal. ED generally⁴ pays the interest accrued during the grace period on all subsidized loans; unsubsidized loans, however, are not eligible for this benefit, so the borrower is responsible for paying the interest that accrues during grace.

A few conditions can alter the length of the grace period, including re-enrollment at least half time and active military duty. Consolidating loans during the grace period terminates any time remaining in the grace period and causes immediate entry into repayment.

Repayment

After the grace period ends, a borrower generally must begin making payments on a monthly basis. The monthly payment amount varies based on the borrower's repayment plan. The repayment plans available to student borrowers repaying federal loans include:

- Standard repayment
- Graduated repayment
- Extended repayment
- Income-based repayment
- Income-contingent repayment (FDLP only)
- Pay As You Earn repayment (FDLP only)
- Income-sensitive repayment (FFELP only)

⁴ Congress has suspended this subsidy temporarily: loans first disbursed on or after July 1, 2012, and before July 1, 2014, do not receive the grace period interest subsidy. Under current law, subsidized loans first disbursed on or after July 1, 2014 will receive the grace period interest subsidy.

While some of these plans have specific requirements and certain limitations, in general, a borrower can work with his or her loan servicer to switch repayment plans (generally up to once per year), unless the loan enters default. Switching from the standard 10-year repayment plan to a more flexible model, like the income-based repayment (IBR) plan, can be an invaluable tool for a borrower who is struggling to make payments since payments under an IBR plan are based on the borrower's income and household size. However, based on new reports and increasing research, many students fail to utilize this type of repayment plan.

Delinquency

Regardless of the repayment plan, the loan will enter delinquency after a borrower misses a payment for the first time, and remain in delinquency until the borrower makes payments to bring the account current. If 270 days pass⁵ with no payments made, the loan enters default.

The number of days by which a loan is delinquent is better understood as a measure of the number of missed payments. For instance, if the loan is 60 days delinquent, the borrower has failed to make two consecutive monthly payments. In the context of default, if the loan is 270 days delinquent, the borrower has failed to make 9 consecutive monthly payments. From a borrower's perspective, loan default is certainly the worst outcome, but even simple delinquency can bring undesirable consequences. Loan servicers report delinquent loans to nationwide consumer reporting agencies, at which point the delinquency begins to impact the borrower's credit score. In addition to the adverse consequences of a lower credit score, borrowers with delinquent loans can experience issues signing up for utilities, homeowner's or car insurance, cell phone plans, and apartment rentals; and can even have difficulty obtaining employment in some cases.

Deferment

Fortunately, a distressed borrower has options for averting delinquency and default, even if he or she is unable to make payments. In consultation with a servicer, an eligible borrower may enter deferment, a period during which principal payments are not required, similar to the 6-month grace period. The length of a deferment can vary widely. A variety of circumstances can qualify a borrower for a deferment. These include, but are not limited to, re-enrollment at least half time; unemployment; economic hardship; and military service during a war, operation, or national emergency. As during the grace period (in most cases), ED pays the interest that accrues on subsidized loans during a deferment. For unsubsidized loans, interest continues to accrue during the deferment period and may be capitalized if the borrower does not pay the accruing interest. Capitalization is the addition of accrued interest to a borrower's loan principal, resulting in an increased outstanding loan balance.

Forbearance

Forbearance is another tool available to assist a borrower in meeting his or her loan repayment obligations. Forbearance is another method of postponing payments on a student loan; it is available to a borrower who does not qualify for a deferment. A borrower requests a forbearance with his or her loan servicer. The servicer has the discretion to grant or deny a forbearance that was requested on the grounds of financial hardship or illness; however, there are a number of circumstances under which the servicer is required to grant a forbearance. Unlike during a deferment, the borrower is responsible for paying the interest that accrues on all loans during a forbearance, and the interest may be capitalized during the forbearance period.

Deferments and forbearances are temporary measures; once they expire, regular payments must resume or the loan will once again become delinquent.

Default

Given the number of options available to avoid default, one might think that relatively few borrowers would default within the timeframe to affect an institution's CDR. While it is true that many borrowers (as many as half of all eventual defaulters, by some counts) will default on their loans after the cohort default period is over, many default within the 3-year monitoring period, negatively affecting their institutions' CDRs.

While a federal loan is technically in default on the 271st day of delinquency, the borrower is added to the CDR numerator:

- At the time of claim payment by a guarantor on a FFELP loan.
- On the 361st day of delinquency on a Direct loan.

Even at such a late stage of delinquency, a borrower often still has alternatives shortly after the loan is in technical default; in other words, the school can still take certain measures to help keep a borrower with a loan in this status out of its CDR calculation. Often, relatively simple issues obstruct a borrower from utilizing his or her options to avoid default.

Although borrowers agree to update their contact information as a provision of their promissory notes, the lenders, servicers, and schools charged with contacting borrowers with delinquent loans to remedy the situation frequently find the information inaccurate or outdated. This prompts them to engage in "skip tracing" in an effort to locate their borrowers. Despite efforts at contact and remediation, many borrowers default having never made a payment, utilized relief options, or made contact with their servicers. If these borrowers could be contacted and offered flexible repayment plans, deferments, or other default avoidance options, they would present a significant opportunity to lower the default rates of entire cohorts.

⁵ 330 days for Federal Family Education Loan Program (FFELP) loans with payments due less frequently than once per month.

Defaulted FFELP loans are transferred to their respective guarantors for collections while defaulted Direct loans are transferred to ED's collection agency. The borrower no longer has the option of switching to a more affordable repayment plan, cannot request a deferment or forbearance, loses eligibility for future federal student aid pending rehabilitation or reinstatement, and the default is reported to nationwide consumer reporting agencies. As with a borrower who defaults on any type of debt, a student loan borrower who defaults has done serious damage to his or her credit score and financial future. However, unlike most loans, student loans are generally not dischargeable through bankruptcy.

If the borrower does not voluntarily make arrangements to pay the debt, the guarantor or ED's collection agency can garnish a borrower's wages, collect IRS refunds through tax offsets, or both. It's important for the borrower to make arrangements to repay because the defaulted balance can actually continue to grow due to additional collection fees, late fees, the ongoing accrual of interest, and the court costs and attorney's fees that may be charged to the account should the loan holder take legal action against the borrower, which has happened in some cases. In some states, a borrower with defaulted loans may not be able to renew a professional license until he or she makes arrangements to repay.

Rehabilitation

Once a loan enters default and the default is reported in the National Student Loan Data System (NSLDS), the borrower is included in the CDR numerator. However, if the borrower can correct the default within the cohort default period through the rehabilitation process, the borrower can be removed from the numerator, thereby positively impacting the CDR. Rehabilitation of a defaulted loan occurs when a borrower voluntarily makes nine payments within 20 days of their monthly due dates over a period of ten months. Payments obtained involuntarily, as through wage garnishment or other legal action, do not count towards the nine required payments for rehabilitation. To accomplish this goal, a borrower can work with his or her guarantor or ED collection agency to negotiate payments that are reasonable and affordable based on the borrower's income and household size.

If a borrower who defaults early within the cohort monitoring period can be quickly detected and counseled onto the path of rehabilitation, it is possible to lower the CDR (note that this is not a viable strategy for borrowers who default late in the cohort default period, due to timing). An additional benefit to the borrower is that after the loan rehabilitation is complete, the guarantor or ED collection agency will request that the borrower's credit report be updated to remove the default status.

Overall, it is always simpler and better for both borrowers and schools if interventions can target troubled borrowers before their loans default; but borrowers, schools, servicers, and guarantors should not stop trying to get a loan back into healthy repayment once it defaults.

BRIEF HISTORY OF CDRS

The federal government first began publishing school-specific lifetime default rates on student loans as an instrument of institutional accountability through consumer awareness, not regulatory sanction. As default rates climbed to over 20 percent in the mid-1980s, it became increasingly clear to policymakers and a concerned public that additional regulation was needed to control student loan defaults. Then-Secretary of Education William J. Bennett responded by proposing the cohort default rate (CDR) methodology, along with sanction thresholds, in 1987.⁶ Congress adopted the policy in the Omnibus Budget Reconciliation Act of 1990 (Act), establishing the two-year CDR as a formal accountability mechanism. Under the Act, an institution would lose eligibility to participate in key federal aid programs (established by Title IV of the Higher Education Act of 1965 [HEA], as amended) were its cohort default rate to exceed 35 percent for fiscal years (FY) 1991 or 1992 and 30 percent for any year thereafter.

The law appeared to produce the desired effect. CDRs declined sharply, falling from an all-time high of 22.4 percent in 1990 to 10.7

percent by 1994 and even further to 6.9 percent in 1998. By that point, hundreds of institutions with high default rates (and, generally, low graduation rates and poor employment outcomes) had closed their doors. Citing these figures, leaders at some institutions, particularly for-profit institutions and some community colleges that tend to serve higher-risk students, called for the restrictions to be loosened, arguing that truly poor-quality institutions had been successfully filtered out but that the extension of tight controls would begin to pose serious danger to proven institutions. In response to these calls, budgetary exigencies, and a desire to provide relief to troubled borrowers, Congress changed the definition of the CDR and the method by which it was to be calculated as part of its 1998 renewal of the HEA.⁷ Most significantly, the period over which a loan could be delinquent before being considered defaulted expanded from 180 days to 270 days, which allowed borrowers in delinquency more time to improve their financial circumstances or apply for a deferment or forbearance. However, student loans also became nondischargeable in bankruptcy.⁸

⁶ Sommer, John W. *The Academy in Crisis: The Political Economy of Higher Education*. Transaction Publishers: New Brunswick, NJ. 1995.

⁷ Lederman, Doug. "A More Meaningful Default Rate". *Inside Higher Ed*. 30 Nov 2007. www.insidehighered.com/news/2007/11/30/defaults.

⁸ New America Foundation. "Federal Student Loan Default Rates". 29 Aug 2013. <http://febfp.newamerica.net/background-analysis/federal-student-loan-default-rates>.

The expanded delinquency period caused the number of borrowers entering deferment or forbearance to more than double in the late 1990s. Research showed that many borrowers technically in repayment cohorts shifted between delinquency, deferment, and forbearance statuses for the full 2-year cohort default period without ever making a payment and then defaulted immediately afterward.⁹ Further research suggested that the two-year window itself is inadequate, as the average default occurs four years after entering repayment and the substantial disparities in outcomes between borrowers of different amounts generally do not appear for at least three.¹⁰ These limitations, exacerbated by the switch from the 180- to 270-day default definition, limited the ability of the 2-year CDR to provide an accurate, timely measure of student financial outcomes or institutional quality.¹¹

Congress corrected for some of these shortcomings by directing in its 2008 HEA reauthorization (known as the Higher Education Opportunity Act [HEOA]) that ED collect and report default data by institutional sector and phase out the 2-year CDR in favor of a 3-year measure. Since the passage of the HEOA, schools have been learning about and preparing for 3-year CDRs. This transition began in FY 2009 with the publication of the first 3-year CDR, and will be complete in September 2014, with the publication of the third 3-year CDR (for FY 2011). As the additional year of monitoring has naturally resulted

in increased rates, the trigger threshold for sanctions has gone up as well, from 25 percent to 30 percent for the multi-year sanction. Further, the new regulations involve a more complex system of other requirements and penalties that will be discussed below.

The 3-year CDRs are considerably higher than the 2-year rates. Comparing FY 2009 cohorts, over 200 institutions had 3-year CDRs in excess of 30 percent but did not hit the 25 percent threshold on their 2-year CDRs.¹² The additional year of monitoring has also revealed greater variation among institutional default rates (that is, it has revealed institutions that had roughly similar CDRs over a two-year period but drastically different CDRs over the 3-year period). Finally, troubling patterns have emerged among the institutions exceeding threshold levels under the 3-year CDR. Institutions with FY 2009 3-year CDRs greater than or equal to 30 percent tend to serve student bodies with far higher percentages of minority and low-income students (as indicated by the percentage of students receiving the Pell grant), and also have an average graduation rate four percentage points lower than schools with lower CDRs.¹³ Early patterns suggest that institutions serving larger populations of high-risk students (who are more likely to default after the soon-to-be-phased-out 2-year window) without delivering more positive financial outcomes may face sanctions.

CONSEQUENCES OF HIGH CDRS

Defaulting on student loans carries serious consequences for borrowers; given the use of CDRs as an accountability mechanism, enough defaults within a student cohort can cause problems for institutions as well, as they are interpreted as indicating a lack of administrative capability. Schools should be familiar with the risks to their borrowers and themselves in order to inform and counsel their students as well as protect themselves from sanctions.

The most straightforward consequence of high CDRs is the loss of eligibility for financial aid programs. Under current law, an institution loses eligibility to participate in Title IV aid programs (including the Federal Direct Loan and Pell Grant programs) when its official 2-year CDR is 25 percent or greater for three consecutive years or at least 40 percent for a single year. The school may also be placed in a sort of probationary status known as “provisional certification” if its 2-year CDR equals or exceeds 25 percent for a single year or if two of its last three 3-year CDRs are 30 percent or greater.

These levels are changing, with new regulations applicable as the 3-year CDR phases in. The sanction threshold for a single, excessively high CDR will remain at 40 percent under 3-year monitoring, while 30 percent will replace 25 percent as the level at which a cohort counts toward sanctions based on a multiple-year rule (three consecutive CDRs or two of the most recent three). These levels take full effect in September 2014, when three years of 3-year CDRs will be available.

A school that hits these triggers does have a few options at its disposal for trying to maintain eligibility or avoid provisional certification. Each spring, ED releases draft CDRs to institutions that carry no legal weight and are not available to the general public. A school that questions the accuracy of its draft CDR generally has 45 days to file a challenge with ED.

A school may issue two distinct types of challenges to a draft CDR: an incorrect data challenge or a participation rate index challenge.

⁹ U.S. Department of Education, Office of Inspector General. *Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs* [ED-OIG A01-C0017]. 22 Dec 2003. www.ed.gov/about/offices/list/oig/auditreports/a03c0017.pdf.

¹⁰ U.S. Department of Education, National Center for Education Statistics, Institute for Education Sciences. *Dealing with Debt: 1992-1993 Bachelor’s Degree Recipients 10 Years Later*. June 2006. <http://nces.ed.gov/das/epubs/2006156/index.asp>.

¹¹ Dillon, Erin. “Hidden Details: A Closer Look at Student Loan Default Rates”. Education Sector. 22 Oct 2007. www.educationsector.org/publications/hidden-details-closer-look-student-loan-default-rates.

¹² Kabaker, Jennifer Cohen. “3-Year Student Loan Cohort Default Rates Reveal Concerning Graduation Rate Trends”. New America Foundation. 2 Oct 2012. http://edmoney.newamerica.net/blogposts/2012/3_year_student_loan_cohort_default_rates_reveal_concerning_graduation_rate_trend-7220.

¹³ *Ibid.*

The incorrect data challenge alleges that the rate was miscalculated due to the inaccurate composition of the CDR’s numerator and/or denominator. The participation rate challenge, on the other hand, allows an institution that has CDRs above trigger levels to avoid sanctions if a small enough percentage of the school’s students borrowed federal loans as determined by the participation rate index formula.

Since challenges are limited to draft CDRs, a school that wishes to question one or more official CDRs must utilize adjustments and/or appeals. These can be divided into two general types: alleged errors and alleged exceptional mitigating circumstances, which can be based on a variety of claims.

Schools submit these challenges and appeals using ED’s eCDR process. Detailed guidance on the various challenge and appeals processes, including the extensive data reporting requirements necessary for each type of challenge and appeal are available in ED’s

Cohort Default Rate Guide. A school is strongly encouraged to utilize this guide to determine which type of challenge, adjustment, or appeal should be submitted depending upon the school’s situation.

Alleged Errors

- Introduction of new, incorrect data between publication of draft rate and official rate
- ED failed to make corrections after incorrect data challenge
- Defaulted loans were improperly serviced

Alleged Exceptional Mitigating Circumstances

- High percentage of low-income students
- Low participation rate index
- For average rate CDRs, calculation with non-average rate would be below trigger rate
- ≤30 borrowers in the 3 prior years’ cohorts

BENEFITS OF EXCEPTIONALLY LOW CDRS

ED provides a limited set of benefits for institutions whose CDRs fall below certain thresholds. These benefits provide some additional flexibility for institutions with a stronger track record through looser restrictions on financial aid administration, including:

- For three consecutive CDRs that are less than 15 percent, a school may
 - Disburse one-semester loans in single installments.
 - Waive the 30-day delayed disbursement requirement for first-year, first-time students enrolled at least half time.
- For a most recent CDR that is less than 5 percent, a school may also
 - Disburse study abroad loans in single installments regardless of loan period.
 - Waive the delayed disbursement requirement for loans for study abroad.

Institutions with low CDRs will also be well positioned to adapt to new accountability mechanisms. Recent developments suggest that major regulatory changes might be on the horizon. ED has continued its efforts to draft a set of gainful employment regulations, and

President Obama has proposed a comprehensive ratings system that would account for several aspects of a school’s student body and student outcomes. With little doubt, CDRs will be implicated if not directly utilized in any new regulatory framework. For instance, a new ratings system might incorporate school-wide and/or program-specific graduation rates, employment rates, or debt-to-income ratios, which all correlate strongly with default risks. An institution whose borrowers tend to stay in healthy repayment will likely be better positioned to perform well under other accountability mechanisms the government might implement.

Beyond regulatory concerns, schools that are able to maintain low CDRs stand to benefit in a number of important ways. All official CDRs are open to the public, and new online tools make this information and other school-specific data more accessible than ever. An institution with a high or even moderate CDR may experience some difficulty in recruitment and enrollment, which can be especially damaging given expanded reliance on tuition dollars in recent years. Anecdotally, the alumni of a low-CDR school will likely be more satisfied with their educational experience, which may benefit the school through positive publicity and alumni donations.

PATTERNS IN DELINQUENCY AND DEFAULT

Loan delinquency is strongly associated with an increased risk of default.¹⁴ Intuitively, this comes as no surprise — after all, a defaulted loan must always have become delinquent first — but it does indicate that, of all loans that become delinquent, many will result in default, and higher delinquency rates will tend to precede higher default rates. However, the delinquency period has historically been an opportunity for research since it has been poorly understood and not studied in a substantive way.

New research approaches have harnessed loan delinquencies to study trends and patterns in loan outcomes. Insights gained from this research stand to contribute to more efficient and effective methods of default prevention. The following section briefly outlines the nascent research into delinquency patterns, presents findings of TG’s original analysis of delinquency, and discusses how these findings can better inform our understanding of how and when student borrowers run into trouble with their loans and what can be done to ameliorate it.

¹⁴ Woo (2002).

Although ED has systematically monitored CDRs for decades, it has not similarly tracked institutional student loan delinquency rates. Until recently, both the government and general public have paid relatively little attention to the most fundamental factor that underlies whether a borrower defaults on a loan — whether she or he ever misses a payment in the first place. ED has not traditionally collected or studied FFELP delinquency data, therefore, few analyses of national trends in student loan delinquency have been conducted. This situation could be remedied, though, now that all student loans are originated through the FDLP. Federal loan servicers report delinquent loan payments to the NSLDS. Currently, however, this information is available primarily only to schools for the purpose of managing their default rates.

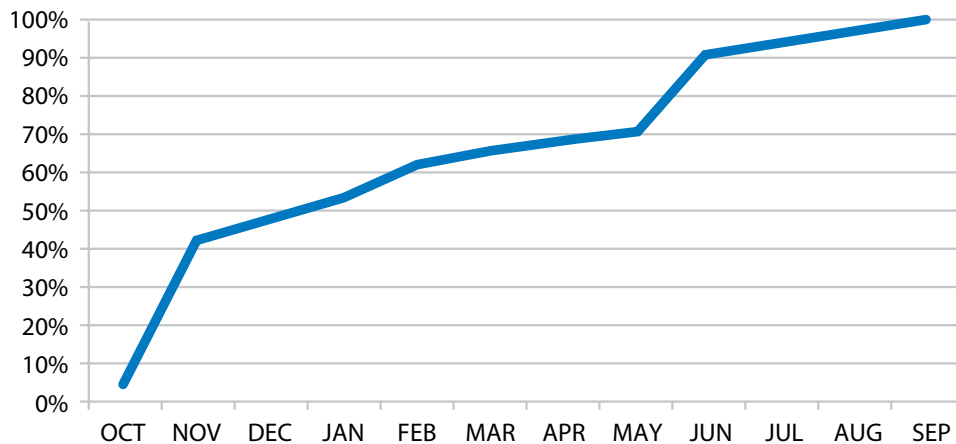
In the 2011 report “Delinquency: The Untold Story of Student Loan Borrowing,” the Institute of Higher Education Policy (IHEP) addressed the gap of knowledge in student loan delinquency by analyzing the repayment patterns of borrowers in the 2005 cohort. The opportunity was a unique one, in that IHEP collaborated with five guarantors and was able to follow the repayment activities of approximately 1.8 million borrowers for five years. The results of the investigation were striking — IHEP researchers found that over 40 percent of the borrower population missed at least one payment during the study period.¹⁵ Even though only 15 percent of these borrowers eventually defaulted during this timeframe, the evidence suggests that a substantial proportion of student borrowers have difficulty in

meeting their loan obligations at some point in time. Because loan holders can and do report failure to make payments on student loans to nationwide consumer reporting agencies, such borrowers are at risk for negatively affecting their credit ratings and impacting their opportunities to borrow consumer loans in the future.

Research suggests, however, that just as not all borrowers appear to be equally at risk for defaulting on a student loan, patterns in delinquency differ across key borrower and institutional characteristics. For example, the IHEP data indicated that borrowers who completed their programs of study were less likely to have delinquent loans than were borrowers who did not graduate from their programs. This pattern held consistent across school types, although the degree of difference between the groups did vary across sectors. In the case of borrowers from public four-year and private nonprofit four-year institutions, failure to graduate was associated with over twice the likelihood for delinquency or default. The gap between the delinquency rates for completers and noncompleters from for-profit and public two-year schools was proportionately smaller. However, this is partially a result of the fact that the overall incidence of delinquency for borrowers who attended these schools was itself very high (i.e., between 53 percent and 63 percent).

Examination of TG delinquency patterns have revealed several trends that hold constant across cohorts. The following charts and accompanying text provide insight on these trends.

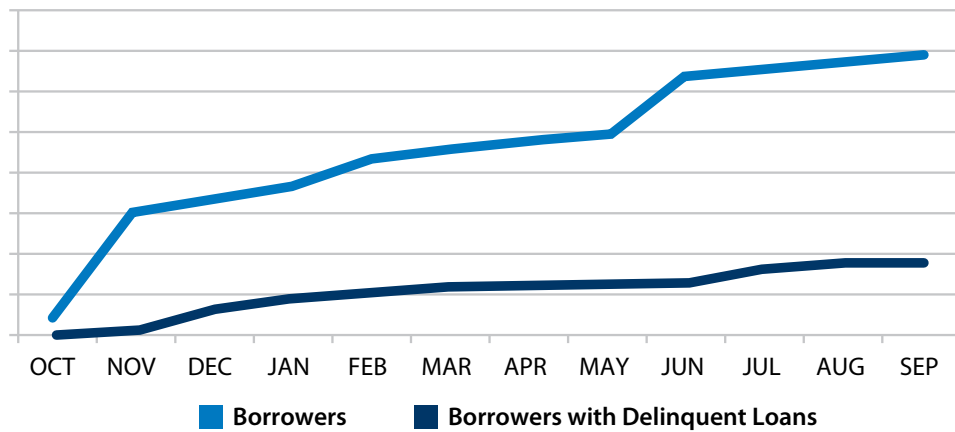
Growth of Cohort during the First Year



- Multiple factors play into the timing of delinquencies throughout the cohort monitoring period, the most fundamental of which is the transition of borrowers from grace into repayment during the first year. As borrowers leave school and, subsequently, exhaust their grace period, the cohort repayer base builds at a steady pace, with peak periods of growth beginning in the months of November and May, corresponding to borrowers’ departures from college in May and December, respectively, of the prior year.

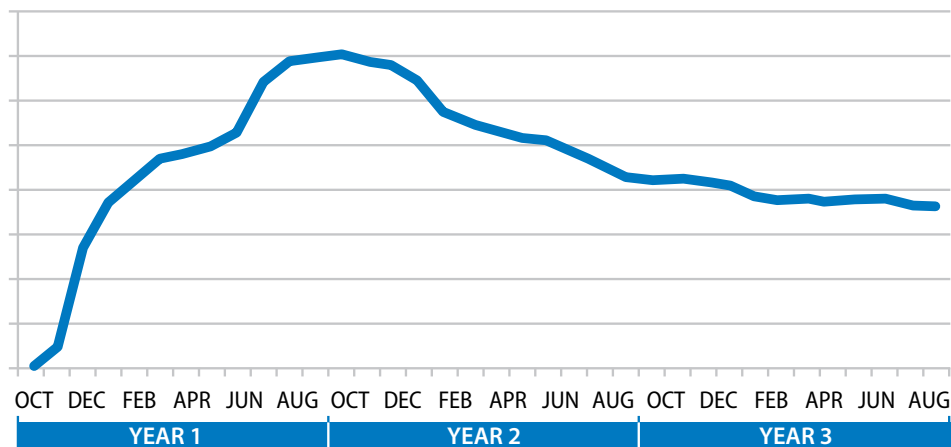
¹⁵ Cunningham, A.F & Kienzl, G.S. (2011).

Cohort Growth and Delinquency Pattern during the First Year



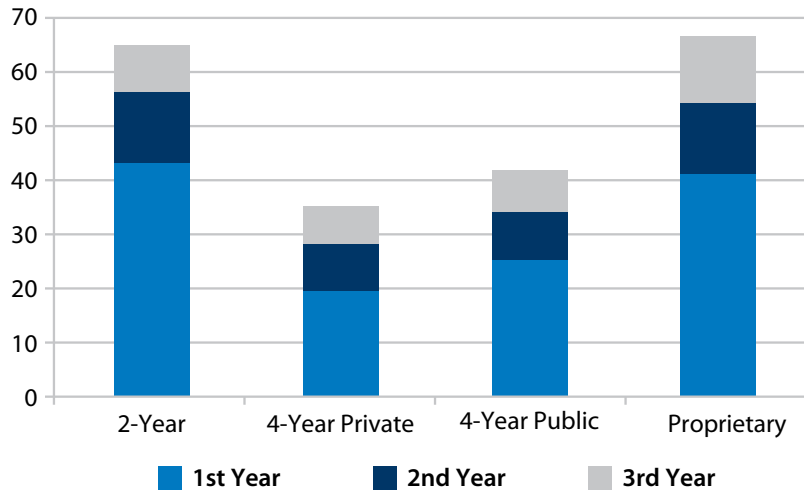
- Examination of cohort delinquency rates from month-to-month reveals seasonal trends. During the first year of the cohort, in particular, spikes occur between December-January and July-August. The peaks in delinquencies lag slightly behind the peaks in which borrowers enter the cohort, as borrowers' first payment due dates frequently are not scheduled for the first day in which they enter repayment on their loans. Instead, initial payments for Stafford/Direct loans are typically scheduled to start no later than 60 days after the repayment start date.

Delinquency Pattern during the Three-Year Monitoring Period

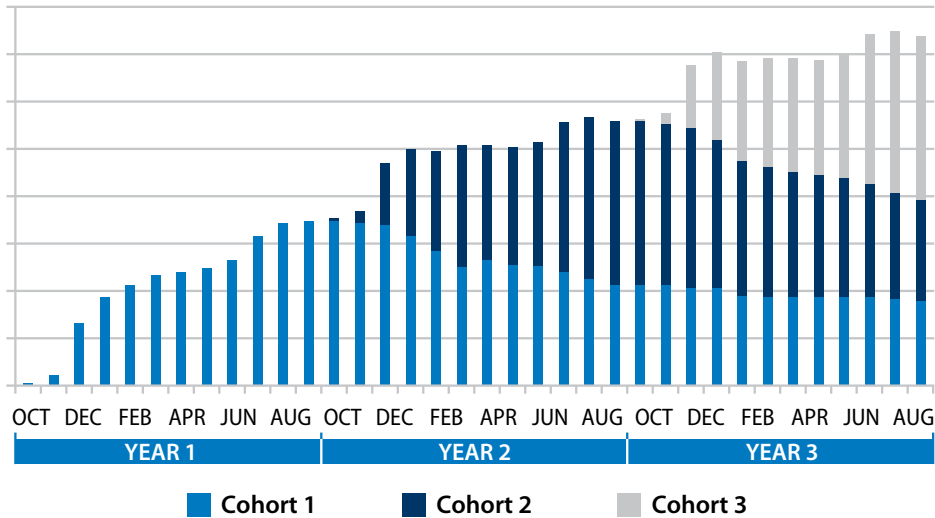


- Cohort delinquency rates begin to decline slowly during the first three months of the second year of the cohort period, primarily because 1) no new repayers are entering the cohort and 2) some loans have been delinquent long enough to have a claim filed and paid, thereby removing them from the pool of potentially delinquent loans. This trend holds across all school sectors. The decrease in delinquency rates continues to occur very gradually during the third year, but generally remains between 10 and 15 percent for 4-year public and private institutions and between 20 percent and 25 percent for 2-year and proprietary schools throughout the year.

Cumulative Delinquency Rate by Year of First Delinquency



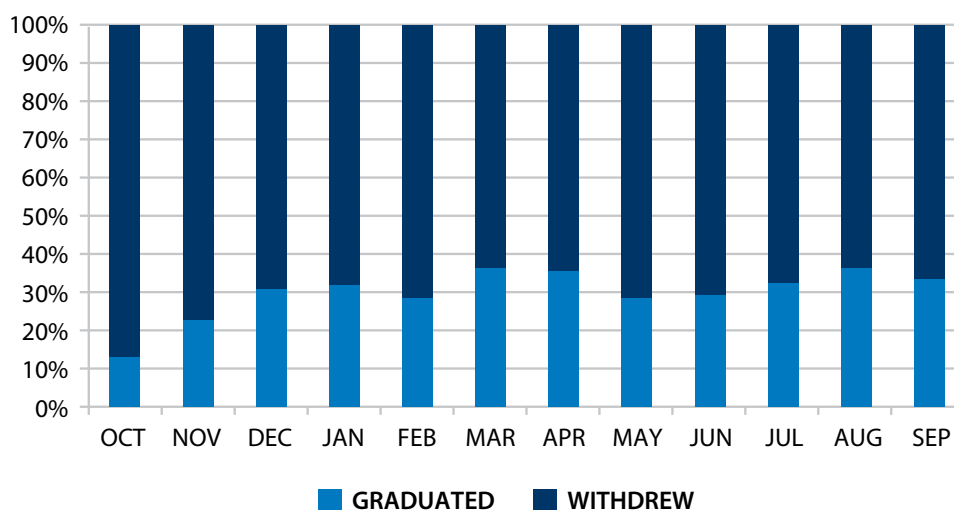
- Delinquency rates vary widely across school sectors. While approximately 40 percent of borrowers who attended four-year schools have a delinquent loan during their first three years in repayment, two-thirds of borrowers from 2-year and proprietary schools do. The majority of borrowers who have delinquent loans during the monitoring period initially become past due within the first twelve months after entering repayment.



- The fact that there are three cohorts “open” at a time adds layers of complexity to managing seasonal variation in delinquency patterns. While the oldest cohort is leveling off in the number of borrowers with loans that are becoming or remaining delinquent, the second cohort’s delinquency rate decreases as the number of borrowers with loans that have aged into default increases. At the same time, the newest cohort demonstrates the largest growth in the proportion of borrowers with delinquent loans. Across the cohorts, borrowers are at different reference points with regard to their risk of loan default, dependent partially on the number of days the loan is delinquent and the amount of time left in the cohort’s monitoring period.
- Multiple occurrences of delinquency on a student loan are very common. Nearly 80 percent of borrowers who allow their loans to become delinquent during the 3-year cohort default period do so more than once. Thus, a large proportion of the time, instances of delinquency are not a result of a lack of information regarding when and with whom the repayment process takes place. Instead, a significant number of delinquencies occur after borrowers have successfully established or reestablished an action to meet their loan obligation, either by making a payment or utilizing a deferment or forbearance option.

- Close to half of borrowers with delinquent loans miss three or more on-time payments during the first 36 months in repayment, running the risk — multiple times during a relatively short period of time after exiting college — of damaging their credit and possibly defaulting on their loans. Interestingly, the gaps between instances of a missed payment are large — for example, approximately six months on average for individuals who miss three payments during this time period. This again suggests that delinquencies occur most frequently after borrowers have successfully navigated the repayment process in some manner.
- While recurring incidences of delinquency are somewhat more prevalent for borrowers who attended short-term programs of study than those who attended 4-year schools, patterns related to time gaps between delinquencies and the maximum number of times borrowers' loans become delinquent are similar across school types.

Proportion of Delinquent Borrowers during First Year by Completion Status



- School graduation rates are associated with delinquency rates, in that institutions with higher graduation rates tend to have lower overall cohort delinquency rates. Overall, borrowers who do not complete their program of study are significantly more likely to allow their loans to become delinquent (or default). Delinquencies that occur in the first two months of the cohort monitoring period are particularly dominated by borrowers who withdrew from school before the end of the spring semester.
- However, whether borrowers graduate from a program does not necessarily predict the *number of times* their loans will become delinquent throughout the monitoring period, nor whether they will become delinquent more than once at all.
- Although there is a significant correlation between school delinquency rates and default rates overall, cases where schools with higher than average delinquency rates end up with lower than expected default rates are not uncommon. Variability in the relationship between delinquency and default rates is greatest in the proprietary sector.
- Some trends in delinquency rates and recidivism (i.e., recurring instances of delinquency) appear to be closely tied to particular servicers. More research needs to be conducted to determine the role of individual servicing practices in delinquency patterns over time.

While the above research has focused on the proportion of borrowers whose loans are delinquent during a specific period of time, investigation of factors that influence changes in the absolute number of borrowers with delinquent loans over time is generally lacking. However, the most obvious candidates are increases in student enrollment and higher levels of student loan borrowing. Between 2000 and 2010, national enrollment in postsecondary institutions that award degrees increased by 37 percent.¹⁶ More significantly, student debt grew almost three times between 2004 and 2012,¹⁷ as students began to borrow more per person before exiting college and the number of students who took out federal loans increased. This growth was reflected in a significant rise in the number of borrowers underlying the national default rate, from 3.3 million in the FY 2007 cohort to 4.1 million in the FY 2010 cohort.¹⁸ Most borrowers who entered college during the later years of the last decade are either part of monitored repayment cohorts or will soon be entering such a cohort, resulting in historically high numbers of borrowers whose loan delinquencies and defaults could jeopardize the reputations and eligibility statuses of many schools. Even if the current national trend toward higher delinquency rates and increased severity of delinquency slows, many institutions will still face the challenges of managing large and growing borrower cohorts. As the burden of this challenge grows larger and more complex, the benefits of cohort management expertise based on data-driven strategies and organizational experience will become increasingly valuable for both schools and their borrowers.

¹⁶ U.S. Department of Education, National Center for Education Statistics. (2012). *Digest of Education Statistics, 2011* (NCES 2012-001). Retrieved from <http://nces.ed.gov/fastfacts/display.asp?id=98>.

¹⁷ Lee, D. (2013).

¹⁸ U.S. Department of Education, Federal Student Aid. (2012). *National Student Loan Two-year Default Rates*. Retrieved from www2.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html.

Appendix

FACTORS ASSOCIATED WITH DEFAULT

Due to loan default's crucial importance for both institutions and the students they serve, a great deal of research has focused on identifying factors that are associated with increased likelihood of default, and increased cohort default rates for groups of student borrowers. Depending on the research methodology and theory behind the particular factor in question, these studies may or may not suggest a causal relationship, but they can establish definitively whether a factor bears a general association to default. Understanding these relationships can guide institutional efforts to research their own student populations, design appropriate policies and procedures, and design intervention efforts for at-risk borrowers.

This section is intended as a topical primer to findings of research on loan defaults, not as a comprehensive review of all literature on the subject. It is organized according to category of variable.

College Variables

A number of factors related to student borrower behaviors while in college are associated in some measure with loan default. Whether or not a borrower completes the degree program for which he or she took out student loans is among the most significant of these factors. Borrowers who earn degrees are more likely to become employed and have higher earnings upon leaving school, so they will be far more likely to repay their loans on time.¹⁹ Degree completion may also correlate strongly with an array of other traits, like perseverance or skill at navigating institutions, which would also make a borrower less likely to default.

The significance of degree completion has the counterintuitive result of causing the probability of default to correlate negatively with a student's total loan debt; that is, as the net amount of debt

increases, the odds that the borrower will default decrease. Holding all else equal, higher amounts of debt do not decrease the odds of default, but since higher loan balances often correlate with degree completion, the association exists.

Numerous studies have found that borrowers who earn higher grades are slightly less likely to default than others, but the significance of this association varies from study to study and is generally smaller than that of degree completion.²⁰ Researchers often attribute the effects of grade point average on default (while controlling for other factors) to motivation, preparedness, and other less tangible causes.²¹

On the other hand, the number of courses failed, even when controlling for whether the borrower attained a degree, has a substantial correlation with loan default.²² This could be due to the higher cost of having to repeat credits, a decreased ability to obtain a better paying job for positions that examine a college transcript, or personal characteristics. Research that controlled for degree completion found that failing courses was the strongest predictor of dropping out, which is in turn the strongest predictor of default.²³ Stopping-out (leaving and returning, as opposed to continuous enrollment) is also associated with a higher risk of default.²⁴

A student's choice of major plays a modest role in determining the risk of default. Some studies have found higher default rates among general studies majors versus those who study a hard science or vocational subject.²⁵ Those who change majors more than twice tend to default more frequently, but students who graduate with a second major default less frequently.²⁶ In addition, graduates whose studies align more closely with their jobs after school are less likely to default.²⁷

- ¹⁹ Knapp, L. G., & Seaks T. G. (1992). An analysis of the probability of default on federally guaranteed student loans. *The Review of Economics and Statistics*, 74(3), 404–411. Retrieved from www.jstor.org/discover/10.2307/2109484?uid=3739920&uid=2129&uid=2&uid=70&uid=4&uid=3739256&sid=21102110089067; Woo, J.H. (2002). Factors affecting the probability of default: Student loans in California. *Journal of Student Financial Aid*, 32(2), 5–25; Nguyen, M. (2012). Degreeless in debt: What happens to borrowers who drop out. *Education Sector*. Washington, DC. Retrieved from www.educationsector.org/sites/default/files/publications/DegreelessDebt_CYCT_RELEASE.pdf; Volkwein, J. F., Szelest, B. P., Cabrera, A. F., & Napierski-Prancl, M. R. (1998). Factors associated with student loan default among different racial and ethnic groups. *The Journal of Higher Education*, 69(2), 206–37.
- ²⁰ Flint, T. A. (1997). Predicting student loan defaults. *Journal of Higher Education*, 68(3), 322–354; Christman, D. E. (2000). *Multiple realities: Characteristics of loan defaulters at a two-year public institution*. *Community College Review*, 27(4), 16–32; Volkwein et al (1998); Steiner, M., & Teszler, N. (2003). *The characteristics associated with student loan default at Texas A&M University*. Round Rock, TX: Texas Guaranteed Student Loan Corporation (TG). Retrieved from www.tgslc.org/pdf/tamu_default_study.pdf; Steiner, M., & Teszler, N. (2005). *Multivariate analysis of student loan defaulters at Texas A&M University*. Round Rock, TX: Texas Guaranteed Student Loan Corporation (TG). Retrieved from www.tgslc.org/pdf/tamu_multivariate_analysis.pdf
- ²¹ Volkwein, J. F., & Szelest, B. P. (1995). Individual and campus characteristics associated with student loan default. *Research in Higher Education*, 36(1), 41–72.
- ²² Steiner, M & Teszler, N. (2003); Christman, D. E. (2000).
- ²³ Steiner, M & Teszler, N. (2003).
- ²⁴ Podgursky, M., Ehlert M., Monroe, R., Watson, D., & Wittstruck, J. (2002). Student loan defaults and enrollment persistence. *Journal of Student Financial Aid*, 32(3), 27–42; Steiner, M & Teszler, N. (2003).
- ²⁵ Steiner, M & Teszler, N. (2003); Volkwein, J. F., & Szelest, B. P. (1995).
- ²⁶ Steiner, M & Teszler, N. (2003).
- ²⁷ Flint, T. A. (1997).

Borrowers who are enrolled for the published length of their degree programs tend to default least often, with those who leave earlier (often, without a degree) and those who take longer to graduate tending to default more often. Completing credits over the summer has also been shown to lower the risk of default, sometimes substantially.²⁸

Employment while in school has mixed effects on default rates, often depending on the intensity of a student’s work schedule. While students who work 15 hours per week or less tend to default less often (especially if their jobs are on campus), students who work more hours may run into academic difficulty and have higher default rates overall.²⁹

Campus integration, measured by semesters spent living on campus as well as participation in campus organizations, may also decrease the risk of default.³⁰ Much of this effect can be attributed to higher rates of academic success and degree completion among students who are more integrated in their campuses, although more integrated students may also gain important forms of social capital that benefit them outside of college, for instance in the labor market.

Background Variables

Background variables are non-behavioral factors over which a school cannot reasonably exercise any control. These include demographics as well as past performance, attitude, and aptitude.

Studies on the role of gender in loan default fall into two camps. Many have found a significantly lower rate of default associated with females compared to males,³¹ while others have found no significant relationship whatsoever.³² Age is far less ambiguous, as studies have consistently found a relationship between older student borrowers and higher default rates, perhaps due to the weakening of parental support that might otherwise assist a young borrower.³³

In terms of family background, students who come from White and Asian-American families, higher-income families, and families with better-educated parents all tend to default less often.³⁴ Some studies suggest that these differences mostly have to do with significant

disparities in degree completion rates between ethnic groups as well as income groups, which tend to correlate strongly with parental education.³⁵ Additionally, Hispanic and African-American students tend to experience higher post-college unemployment rates and higher rates of personal and family issues that interfere with repayment, all of which act to increase their default rates.³⁶

Modest relationships exist between measures of academic preparedness and default rates. Higher Scholastic Aptitude Test (SAT) scores, high school class rank, high school course attainment, and high school diploma attainment (as opposed to a General Education Development certification, or GED) are all weakly associated with lower risks of default.³⁷

The Debt

As mentioned above, the total amount of student debt is inversely related to the risk of default, since default functions as a partial proxy of educational attainment. In addition, borrowers who take out very small loans are often students at community colleges who are unable to afford even the very low costs associated with community college attendance, indicating the severity of their financial need. These students are also very unlikely to achieve a degree or other credential.

On the other hand, debts that students perceive as becoming too large can increase the risk of default by increasing the odds of withdrawal. Studies show that students who feel dissatisfied with their college experience (for academic, social, or other reasons) lose willingness to take on student loans, sometimes resulting in withdrawal and thereby increasing the odds of default.³⁸

While a greater loan balance tends to decrease the risk of default, having that balance divided into more loans tends to increase the risk of default, especially if those loans are being serviced by multiple servicers.³⁹ When the debt is divided to such an extent, the burden of making monthly payments and managing any deferments or forbearances increases substantially, resulting in more defaults.

²⁸ Steiner, M & Teszler, N. (2003).

²⁹ Volkwein, *et al* (1998).

³⁰ Steiner, M & Teszler, N. (2003).

³¹ For instance, Volkwein *et al* (1998); Podgursky *et al* (2002); Herr & Burt (2005); Woo (2002) and Flint (1997).

³² Volkwein & Szelest (1995)

³³ Podgursky *et al* (2002); Herr & Burt (2005); Woo (2002); Flint (1997); Christman (2000).

³⁴ Herr & Burt (2005)

³⁵ Volkwein *et al* (1998); Knapp & Seaks (1992)

³⁶ Volkwein & Cabrera (1998).

³⁷ Steiner, M. & Teszler, N. (2003)

³⁸ Baum, S. & O’Malley, M. (2002). College on credit: How borrowers perceive their education debt. *Journal of Student Financial Aid*, 33(3), 7–19. Retrieved from www.immagic.com/eLibrary/FIN_AID/SALMAEUS/N030225B.pdf; Cofer, J. & Somers, P. (1999). An analytical approach to understanding student debt load response. *Journal of Student Financial Aid*, 29(3), 25–44.

³⁹ Woo (2002)

.....

Institutional Variables

Some characteristics of institutions have been shown to relate to default rates to some degree. Institutional sector likely plays some role in the odds of default, as student borrowers who enroll at doctoral degree-granting institutions tend to default less often than student borrowers at other institutions, and borrowers at for-profit institutions tend to default more often.⁴⁰ However, much of the variation between institutions is based on students’ tendency to enroll at institutions where the majority of the student body shares their own basic background characteristics.⁴¹ Students whose backgrounds predispose them to default on their loans generally attend the same set of institutions, while students whose backgrounds make them unlikely to default generally attend others. It is only for students who graduate from institutions that they were unlikely to attend that the impact of the institution itself comes into play, and it tends to be fairly marginal.

Once a student enrolls at an institution, how that student behaves (in terms of grades, employment, continuous enrollment, choice of major, marital status, and the prevalence of dependents) seems to exercise the largest influence in the student’s risk of default. Institutions may encourage or discourage at-risk behaviors and/or mitigate their negative impacts through policies, programs, or other efforts, but it is not clear precisely how large a share of the influence is due to the institution versus individual behavior. However, data do suggest that the characteristics of the student body do not account for the entirety of the difference; the institution appears to play some role.⁴²

Post-College Variables

The two strongest predictors of default among post-college variables are employment and income, with unemployment raising the risk of default significantly more than being employed with low income.⁴³ Family status can also exercise some influence, as borrowers who are divorced/separated or have dependent children while single tend to have higher default rates compared to those who either never marry or get married and remain married over the course of their repayment term. Based on past studies, familial status seems to exercise a larger influence over loan default for non-White borrowers, whose default rates tend to vary similarly but with far greater magnitude when grouping by family status and race/ethnicity.⁴⁴

Past repayment behaviors also tend to impact the future odds of default, with borrowers whose loans have ever been in deferment or forbearance tending to default less often than others, perhaps because they are better informed regarding their repayment options.⁴⁵ Awareness of the loan repayment process varies widely; though many borrowers are troublingly unaware of their options and obligations, studies have not reached a clear consensus regarding the importance of this knowledge with regard to the odds of default.⁴⁶

40 Deming, D. J., Goldin, C., & Katz, L. F. (2011). The for-profit postsecondary school sector: Nimble critters or agile predators? *Journal of Economic Perspectives*, 26(1), 139–164; Avery, C., & Turner, S. (2012). Student loans: Do college students borrow too much — or not enough? *Journal of Economic Perspectives*, 26(1), 165–192. Retrieved from <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.26.1.165>; Kesterman, F. (2006). Student borrowing in America: Metrics, demographics, and loan default aversion strategies. *Journal of Student Financial Aid*, 36(1), 34–52. Retrieved from www.nasfaa.org/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=380

41 Volkwein & Szelest (1995).

42 Avery & Turner (2012).

43 Center for Responsible Lending. (2012). *The State of Lending in America & its Impact on US Households*. Durham, NC: Bocian, D., Davis, D., Garrison, S., & Sermons, B. Retrieved from www.responsiblelending.org/state-of-lending/State-of-Lending-report-1.pdf; Woo (2002).

44 Volkwein *et al* (1998).

45 Woo (2002).

46 Johnstone, D. B., & Marcucci, P. (2007). Financially sustainable student loan programs: The management of risk in the quest for private capital. Prepared for the *Global Center on Private Financing of Higher Education at the Institute of Higher Education Policy*. Washington, DC. Retrieved from ebookbrowse.com/2007-financially-sustainable-student-loan-programs-the-management-of-risk-pdf-d81341522; Volkwein *et al* (1998).

ADDITIONAL TG PUBLIC POLICY PUBLICATIONS

Balancing Passion and Practicality: The Role of Debt and Major on Students' Financial Outcomes, August 2012

State of Student Aid and Higher Education in Texas (SOSA), November 2011

With Great Challenges Come Great Opportunities: Promising Practices of Texas Community Colleges, June 2011

Digging Deeper: An Analysis of Student Loan Debt in Texas, November 2010

How to Graduate High-Risk Students: Lessons from Successful For-Profit Colleges and Schools in Texas, June 2010

The Toughest Test: The Student Loan Liquidity Crisis of 2007-08 in Texas, November 2008

Ready, Willing, and Unable: How Financial Barriers Obstruct Bachelor-degree Attainment in Texas, December 2006

Comments and requests for additional information regarding this report or any of TG's other public policy publications are welcome. Please direct questions to:

Jeff Webster
 Assistant Vice President for Research and Analytical Services
 Phone number: (800) 252-9743, ext. 4504
 Fax Number: (512) 219-4932
 Address: P.O. Box 83100, Round Rock, TX 78683-3100
 Email: jeff.webster@tgslc.org
www.TG.org

HigherEDGE® DEFAULT MANAGEMENT SOLUTIONS

TG's HigherEDGE® Default Management Solutions is a comprehensive, fee-based service designed to help schools prevent federal student loan borrowers from defaulting on their loans. We offer support on multiple fronts to help you take control of your default rate and lower your risk of losing eligibility to participate in the Title IV programs.

To learn more about HigherEDGE Default Management Solutions, visit us online at: www.HigherEDGE.net.





www.TG.org

HigherEDGE®
Default Management Solutions

www.HigherEDGE.net