



Cohort Default Rates: The Perfect Storm

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The smallest percent of increase in cohort default rates from FY 2006 to FY 2007 was in the proprietary sector where increases were 13.4% compared to 25.5% for public schools and 48.0% for private schools. The official FY 2007 cohort default rate data, released on September 14, 2009, showed an increase for all schools of 28.8%. U.S. Secretary of Education, Arne Duncan, was quoted in a press on the release date saying, "The economic downturn likely had a significant impact on the borrowers captured in these rates."

While traditional models look at changes in the overall default rates themselves as a measurement of success or failure in preventing student loan defaults and educational quality, our in-depth research looked at the percent of change as a more accurate measurement. What we found proves that the proprietary sector is the most efficient at preventing student loan defaults, even in a bad economy.

CDR Rate Increases from FY 2006 to FY 2007			
	FY 2006 CDR	FY 2007 CDR	INCREASE
All Schools	5.2%	6.7%	28.8%
Public	4.7%	5.9%	25.5%
Private	2.5%	3.7%	48.0%
Proprietary	9.7%	11.0%	13.4%

The data also confirmed our theory that a significant number of students exercised their rights to consolidate their loans prior to entering repayment, which changed the year the borrower is included in a cohort default rate. This also had a significant impact on the calculations. As demonstrated in the chart below, a significant number of borrowers artificially inflated the denominator used in the FY 2006 calculation which, in turn, artificially lowered default rates.

CDR Borrower Count Changes from FY 2005 to FY 2007			
	FY 2005 CDR	FY 2006 CDR	FY 2007 CDR
All Schools	3,495,584	3,911,640	3,345,534
Public	1,803,195	1,988,185	1,721,629
Private	950,819	1,055,567	778,296
Proprietary	730,385	855,523	838,328

These additional borrowers are the least likely to default because they understand their loan obligations and because many of these students were still in school when they consolidated, thus they were on in-school deferments through the measuring period for the calculation. This "wave" of additional borrowers will have the opposite affect in subsequent cohort default rates which will show lower total borrower numbers in the denominators consistent with the FY 2007 borrower counts.

Borrower options for consolidating in the Federal Family Education Loan Programs (FFELP) no longer exist and the U.S. Department of Education has put a hold on processing consolidation requests through the Direct Loan Program. These dynamics will also impact the future of cohort default rates.

For lack of a better descriptive, we are facing "a perfect storm" for cohort default rates. The following are the most significant factors that will increase default rates in the future:

- Higher loan balances
- Multiple loan programs, lenders, and servicers

- ▣ Multiple payments that are hard to manage
- ▣ Multiple forms needed to cure delinquencies
- ▣ Decline in the quality of loan servicing
- ▣ Bad economy
- ▣ Skip borrowers not located through traditional methods of skip tracing
- ▣ Transition from FFELP to Direct Loans
- ▣ Delinquent PUT loans resulting from loan transfer time with inconsistent servicing
(PUT loans are those purchased by the Department of Education from FFELP loan holders.)

Remember that default rates are measured by borrower counts, not loan counts, so if only 1 of several loans goes into default, it is a default for the student and the school.

Default prevention is more complicated than it has ever been before. All of these factors combined make an effective strategy a moving target. If you think that designing a default prevention plan for a year at a time will be effective, we encourage you to re-examine your strategy. Through recognizing the issues as they arise, defining issue-specific plans, and implementing these new plans in a timely and effective manner, schools can provide much needed intervention. Proactive strategic planning is the key to long-term success.

Waiting to take action could have devastating consequences. The first 3-year cohort default rates, FY 2009, will be officially released in September 2012. At that time, the servicing period for the FY 2010 CDR will be completed. There will be one year of servicing left in the FY 2011 CDR. Taking action at that time will be too late if your school's rates are over the allowable threshold of 30% for 3 consecutive years.

Proactive Default Prevention is Relevant to Successful Results							
LDA Range	10/1/2008	9/30/2009	9/30/2010	9/30/2011	9/30/2012	9/30/2013	9/30/2014
3/30/2008-3/29/2009					<i>Published</i>		
3/30/2009-3/29/2010						<i>Published</i>	
3/30/2010-3/29/2011							<i>Published</i>



Many schools are already facing rates close to or over the 40% threshold. Even before the 3-year CDR rates apply, these schools are subject to sanctions up to and including limit, suspend, and terminate (L, S, & T) sanctions. This threshold will remain 40% under the 3-year definition.

The 2-year CDR definition criteria for sanctions and disbursement benefits are:

- Sanctions can apply for one (1) year over 40%
- Sanctions can apply for three (3) consecutive years over 25%
- Disbursement benefit eligibility can apply for three (3) consecutive years under 10%

The 3-year CDR definition criteria for sanctions and disbursement benefits are:

- Sanctions can apply for one (1) year over 40%
- Sanctions can apply for three (3) consecutive years over 30%
- Disbursement benefit eligibility can apply for three (3) consecutive years under 15%

The 2-year thresholds will be used until there are three (3) consecutive 3-year CDR's published. This will occur in September 2014.

There is language in the Higher Education Opportunity Act (HEOA) legislation that allows schools to be eligible for disbursement benefits under the 15% criteria before the 3-year CDR criteria will be used. As phrased up on Capital Hill and within negotiations for these issues, this will have unintended consequences. Schools will be well advised not to participate in these benefits if the projected default rates under the 3-year definition will be above the eligibility threshold. Exercising your rights for these benefits when loss of the benefit is inevitable will create a negative cash flow when the benefits are lost. This loss in cash flow may have devastating consequences to the schools in the long run.

Cohort Default Rate Definitions					
Effective with the Higher Education Opportunity Act (H.R. 4137 for the HEA of 2008)					
Cohort Year	LDA Range	Repayment Dates	2-year CDR Default Dates	3-year CDR Default Dates	CDR Draft & Official Release Dates
FY 2008 CDR	3/30/2007-3/29/2008	10/1/2007-9/30/2008	Through 9/30/2009		Draft: February 2010 Official: September 2010
FY 2009 CDR	3/30/2008-3/29/2009	10/1/2008-9/30/2009	Through 9/30/2010		Draft: February 2011 Official: September 2011
				<i>Through 9/30/2011</i>	Draft: February 2012 Official: September 2012
FY 2010 CDR	3/30/2009-3/29/2010	10/1/2009-9/30/2010	Through 9/30/2011		Draft: February 2012 Official: September 2012
				<i>Through 9/30/2012</i>	Draft: February 2013 Official: September 2013
FY 2011 CDR	3/30/2010-3/29/2011	10/1/2010-9/30/2011		<i>Through 9/30/2013</i>	Draft: February 2014 Official: September 2014

The best option for managing cohort default rates is to be proactive and to gear up for intense processes that will counteract the situations our students are facing. There is no miracle for successful default prevention. It is complicated, labor intense, and changing on a regular basis. Our best advice is, if in doubt, do more.

Footnote: Data used for this article was publicly released and extracted from the National Student Loan Database System (NSLDS).

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