Cohort Default Rates: The Perfect Storm at Hurricane Force

By Mary Lyn Hammer

Higher education institutions and student loan borrowers face hurricane force headwinds in managing their student loans. What has been called "The Perfect Storm" for Cohort Default Rates (CDR's) for a couple years now has just been upgraded to a hurricane force storm with microbursts across the country. Call it a recession, call it a depression, call it a recovering economy if you'd like. Just don't get so covered up in your raincoat that you fail to see the challenges of these headwinds and the long-term devastating consequences for students and the institutions that serve them.

The most significant headwinds that have already adversely affected CDR's and will continue to fuel increases in the future include:

- 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

Mary Lyn Hammer's belief that *education is the vehicle for making dreams come true* has led her in a passionate fight that began in 1987, rectifying problems in the higher education industry to ensure future participation for all students. Her innovative *"Hands On" Default Management Program* is recognized by the Department of Education for its remarkable results. Ms. Hammer is the owner, founder, president and CEO of *Champion College Services*, an international company offering default prevention for federal and private student loans, job placement verification, skip tracing, consulting services, and custom surveys for students, alumni, and employers.

Ms. Hammer has actively worked with the U.S. Congress and the U.S. Department of Education since 1988. Her many recognized accomplishments include, most recently, the 2005 CCA National Achievement Award for the Allied Member of the Year and 2008 Best Associate Member for the Arizona Private School Association. She has served several terms on the board of directors with the Career College Association (CCA) and the NorthWest Career Colleges Federation (NWCCF) and is the charter member and former chairwoman for the HEAL Coalition (Higher Education Allied Health Leaders Coalition).

Contact Information:
Mary Lyn Hammer
President and CEO
Champion College Services, Inc.
4600 S. Mill Ave., Suite 180
Tempe, AZ 85282
Toll Free: 800-761-7376
Phone: 480-947-7375
Fax: 480-947-7374
Web Site: www.championcollegeservices.com

- Transition from FFELP to Direct Loans
- Delinquent PUT loans resulting from loan transfer time with inconsistent or lesser quality of servicing. (PUT loans are those purchased by the Department of Education from FFELP loan holders.)
- Complications that may arise should Gainful Employment rules become reality.

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

Although the focus of the Obama Administration and the U.S. Department of Education on the quality of education and financial factors of borrower repayment data has been on proprietary schools, it is extremely interesting to see that the proprietary sector has actually weathered the storm with the smallest increases in CDR's over all other sectors of higher education.

While traditional models look at 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 Increases from FY 2006 to FY 2008 By Sector

Ranking of % of Change High to Low		FY 2006 CDR	FY 2008 CDR	Rate Change	% Change
	Total	**5.2%**	**7.0%**	**1.8%**	**34.6%**
1	**Foreign**	1.2%	2.2%	1.0%	83.3%
2	**Private**	2.5%	4.0%	1.5%	60.0%
3	**Public**	4.7%	6.0%	1.3%	27.7%
4	**Proprietary**	9.7%	11.6%	1.9%	19.6%

Other interesting data points showed that there were significant decreases in the number of borrowers in total and at foreign, private, and public institutions. Borrower numbers increased slightly at proprietary institutions at a rate of 3.9 percent and contrary to recent publicity regarding extremely large increases in borrowers at proprietary institutions.

When comparing changes in borrower numbers to changes in CDR's, a noteworthy trend arose.

Change in Number of Borrowers from FY 2006 to FY 2008 CDR's By Sector

Ranking of % of Change High to Low		# 2006 Borrowers	# 2008 Borrowers	Change in # Borrowers	% Change
	Total	**3,911,640**	**3,378,734**	**(532,906)**	**-13.6%**
1	**Foreign**	12,359	7,902	(4,457)	-36.1%
2	**Private**	1,055,567	761,129	(294,438)	-27.9%
3	**Public**	1,988,185	1,720,664	(267,521)	-13.5%
4	**Proprietary**	855,523	889,034	33,511	3.9%

The institutions with the largest decreases in borrower counts had the most significant increases in default rates. Could these trends be the true reflection of quality of education in this country? At traditional public and private institutions, many of which are nonprofit, there are fewer students choosing to attend and borrow student loans to get an education. The percent of those who did attend and chose not to pay their loans drastically increased.

Significance of Change in Borrower Count to CDR By Sector

Ranking of % of Change High to Low		% Change in Borrower Count	% Change in CDR's
	Total	**-13.6%**	**34.6%**
1	**Foreign**	-36.1%	83.3%
2	**Private**	-27.9%	60.0%
3	**Public**	-13.5%	27.7%
4	**Proprietary**	3.9%	19.6%

When the data is broken down into subsectors, the most drastic increases in CDR's are within the foreign and private institutions. Again, many of the private institutions are considered nonprofit.

There is also a commonality of increases in default rates to institutional type. After getting past the extremely high increases for private institutions, there is consistency in the rate of increase as it corresponds to length of program. The longer programs with higher student loan debt had higher increases. Those institutions that serve the higher risk students, historically modeled as those in entry level training programs offered over a shorter period of time, showed the lowest rates of increase.

Could it be that traditional "4-year" education is taking a back seat to shorter programs that offer workforce and career training? Could it be that the difference in cohort default rates is attributable to

CDR increases from FY 2006 to FY 2008 By Subsector						
Ranking of % of Change High to Low			***FY 2006 CDR***	***FY 2008 CDR***	***Rate Change***	***% Change***
	Total		**5.2%**	**7.0%**	**1.8%**	**34.6%**
1	**Foreign**	**All types**	1.2%	2.2%	1.0%	83.3%
2	**Private**	**4 yrs (+)**	2.4%	3.8%	1.4%	58.3%
3	**Private**	**Less than 2 yrs**	10.0%	14.1%	4.1%	41.0%
4	**Private**	**2-3 years**	6.1%	8.2%	2.1%	34.4%
5	**Proprietary**	**4 yrs (+)**	8.4%	10.9%	2.5%	29.8%
6	**Public**	**4 yrs (+)**	3.4%	4.4%	1.0%	29.4%
7	**Public**	**2-3 years**	8.4%	10.1%	1.7%	20.2%
8	**Proprietary**	**Less than 2 yrs**	10.9%	12.4%	1.5%	13.8%
9	**Proprietary**	**2-3 years**	11.1%	12.6%	1.5%	13.5%
10	**Public**	**Less than 2 yrs**	6.4%	6.7%	0.3%	4.7%

public institutions' ability to limit borrowing versus proprietary institutions' prohibition to limit borrowing?

The biggest question for taxpayers remains...*where is the money going?* Most taxpayers don't have any vested interest in whether they are paying for defaulted student loans from public, private, or proprietary institutions. But, since the focus of quality of education has been on the proprietary sector, the following outlines where the largest numbers of defaulted borrowers reside.

# of Defaulted Borrowers from FY 2006 to FY 2008			
Ranking of % of Change High to Low			***# 2008 Defaulted Borrowers***
	Total		**238,852**
1	**Public**	**4 yrs (+)**	54,438
2	**Proprietary**	**4 yrs (+)**	53,808
3	**Public**	**2-3 years**	49,331
4	**Proprietary**	**2-3 years**	34,538
5	**Private**	**4 yrs (+)**	28,916

Proactive default prevention is extremely important with hurricane force headwinds that make implementing an effective CDR strategy a moving target. Beware of designing a default prevention plan for a year at a time when the target changes on a monthly or often daily basis. 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.

Reactive default prevention 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 percent for 3 consecutive years.

The historically bad economy coupled with headwinds caused by the transition from the

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					*Published*		
3/30/2009-3/29/2010						*Published*	
3/30/2010-3/29/2011							*Published*

CDR Definition	Loss of Eligibility		Disbursement Benefits
2-Year CDR	3 Consecutive Years Over 25%	1 Year Over 40%	3 Consecutive Years Under 10%
3-Year CDR	3 Consecutive Years Over 30%	1 Year Over 40%	3 Consecutive Years Under 15%

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
				Through 9/30/2011	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
				Through 9/30/2012	Draft: February 2013 Official: September 2013
FY 2011 CDR	3/30/2010-3/29/2011	10/1/2010-9/30/2011		*Through 9/30/2013*	Draft: February 2014 Official: September 2014

FFELP to the Direct Loan Program has put many schools in jeopardy of losing Title IV funding. Some are facing rates close to or over the 40 percent 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 40 percent threshold will remain in effect under the 3-year definition.

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

Lawmakers refer to "unintended consequences" of law and rulemaking. Legislation in the *Higher Education Opportunity Act (HEOA)* and related regulations allow institutions to qualify for disbursement benefits prior to the effective date for sanctions within the new definitions and after the increased thresholds become effective. For example, a school may qualify for disbursement benefits under a 2-year CDR definition and a 3-year 15 percent 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 "unintended consequence" for loss in cash flow may have devastating consequences to the schools in the long run.

By this time, you may be asking yourself, "What Can I Do to Better Weather the Storm?" The answer is:

Make Students Responsible for Their Own Realities!

Successful default prevention and higher repayment rates lies in student accountability. Consider the following factors to reach the accountability level needed for low default rates and high repayment rates:

- Master promissory notes and electronic processes have had unintended consequences by taking the responsibilities out of the borrowers' hands.
- Get the students involved in the responsibilities:
  - Individual Entrance Interviews
  - Check Disbursement Acknowledgements

- Individual Exit Interviews
- Address and Enrollment Updates

- Use every opportunity you can during and after enrollment to encourage interest payments during deferments and forbearances.
- Encourage payments first. If the borrower can't make full payments, encourage them to pay the accruing interest at a minimum. You cannot require them to do so, but you can encourage the payments.
- Repeat the basics MANY times.
- Put complicated details in writing.
- Have every borrower with prior loans bring the loans current before starting school.
- If the borrower is in default, have them fully rehabilitate the loan before starting school.
  - 9 on-time payments within 10 months
  - Paid-in-Full
  - Rehabilitated through Consolidation
  - *Getting a new loan after 6 on-time payments does not rehabilitate the loans for the student or for the school!*
  - Have every borrower sign an In-school Deferment when starting school and when there is a change in their anticipated graduation date.
- Have students sign Change of Address Forms for the lenders, servicers, and guarantors.

Communications with potential, current, and past students are based on your ability to contact them. You can't help those students who you can't find. Because skip tracing has become a manual process, the following suggestions may help you locate them to ensure necessary communications:

- Collect at least 6 different references
- Verify the references before disbursing funds
- Mail grades and other pertinent information
- Send out graduation announcements to "references" collected before graduation
- Collect the graduation announcement information through your teachers or student services, not through financial aid

There is no one miracle for successful management of cohort default rates. Proactive default management is an investment. Reactive default management is a consequence. A combination of many different techniques and procedures for default prevention produces more effective results. If there is any question about what to do right now...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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