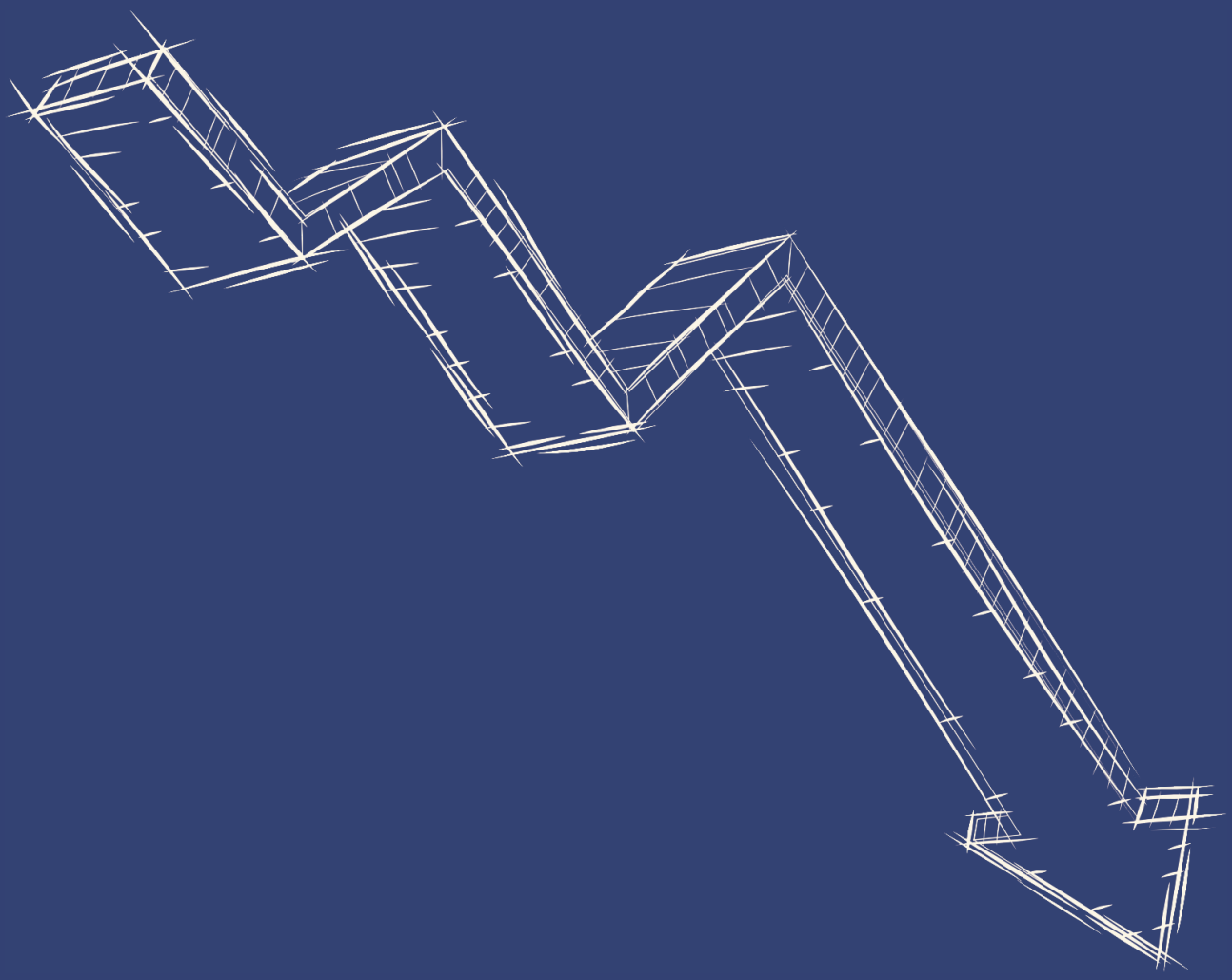
TICAS

Driving Down Default

How to Strengthen the Cohort Default Rate to Further Reduce Federal Student Loan Default Risk



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Introduction

With increasing alarm that student debt leaves some students worse off than if they had never gone to college at all, policymakers and student advocates have proposed a range of options to increase college affordability and prevent unaffordable debt. Experts rightly point to the need to improve measures of federal student loan repayment and better hold schools accountable for unacceptable outcomes. In the course of advancing this important goal, some have suggested the cohort default rate (CDR) has outlived its utility, and should be scrapped rather than strengthened.[1] In fact, the combination of growing concern about poor student loan outcomes and the metric's real shortcomings point to critical opportunities to address the CDR's weaknesses rather than abandon its goals, and it is essential that policymakers do so.

The CDR is the federal government's most longstanding student debt outcome measure, established almost 30 years ago with bipartisan support under the George H. W. Bush Administration. It is a reliable, well-established, and widely understood measure, supported by processes for data verification and appeals. The CDR's use in college accountability is grounded in the strong federal interest in tracking how often students experience the single most devastating student loan repayment outcome: default. Holding colleges accountable for their CDRs has a long track record of effectively reducing the risk of student loan default. Schools can and do meaningfully lower their CDRs without limiting students' access to federal loans, and the CDR remains critical for ensuring schools do not consistently leave significant shares of their students with unaffordable debt.

Decades of experience have also revealed weaknesses that policymakers must tackle to maintain the meaningfulness and effectiveness of the CDR and further reduce defaults. Some colleges evade CDR accountability by taking advantage of forbearance options that postpone payments and delay, rather than prevent, default or by manipulating how defaults are attributed to different associated campuses to mask concentrated risks. The pass-fail structure of the CDR does not provide all passing schools with strong enough incentives to continue to improve. Finally, Congress has not revisited the maximum allowable CDR rate since the 2008, despite clear need for colleges to further reduce the risk of default.

To strengthen the CDR and further reduce student loan defaults, we recommend that policymakers:

- Publish five-year default rates and hold schools accountable when patterns of default suggest forbearance abuse;
- Prevent colleges from evading CDR accountability by shifting or reclassifying campus reporting structures;
- Introduce interim consequences for schools with CDRs below the failing threshold in order to provide incentives for more colleges to reduce student loan defaults;

- Reduce the maximum allowable CDR to further drive down defaults; and
- Account for a school's borrowing rate in the CDR itself to more transparently target colleges posing high risk of default to their students.

CDR Basics

The CDR is an important accountability measure that tracks borrowers' risks of default across comparable groups over time and across schools. While different metrics, such as measures of progress in paying down debt, illuminate a broader range of student loan outcomes, the CDR measures the share of borrowers who experience a specific, devastating borrowing outcome — default. The CDR's use in accountability is designed to prevent taxpayer money from subsidizing enrollment in schools that routinely leave their students in default within a short period of time after leaving college.

The CDR is calculated as the share of borrowers who entered repayment in a single fiscal year who defaulted by the end of the second following fiscal year (within 24 to 36 months of entering repayment, depending on the time of year the borrower entered repayment). A student loan borrower enters default after 270 days of delinquency (failing to make required payments). For the purposes of collection and inclusion in the CDR, a borrower is considered in default after 360 days of nonpayment.

The Department of Education calculates a CDR for each school each year and uses it to determine continued eligibility for federal student aid. Schools with a CDR exceeding 30 percent for three consecutive years, and where a significant share of students borrow student loans, are subject to the loss of federal student loans and Pell Grants for two subsequent years. Schools with CDRs exceeding 40 percent for a single year are subject to the loss of access to federal student loans.

The CDR system also includes processes for data validation and allowances for challenges and appeals, which are designed to protect the integrity of the system by ensuring accuracy of the underlying data, as well as appropriateness of assessing the institution's performance based on the rate.

Key History and Trends of the CDR

In the late 1980s, policymakers recognized the need to address the high cost of student loan defaults, many resulting from loans borrowed to attend fly-by-night trade schools and other for-profit colleges. In 1987, then Secretary of Education William Bennett proposed that colleges with high default rates should lose eligibility for federal student aid.[2]

"We must be skeptical about the real educational opportunities provided by institutions with very high default rates – since high default rates tend to correlate with high dropout rates and other institutional deficiencies."

Former Secretary of Education William Bennett (December 1987)

Eighteen months later, in June 1989, the Department of Education issued regulations that revoke student aid eligibility from colleges with a high CDR in any one year, setting a maximum threshold of 60 percent beginning in 1991 and declining by five percentage points a year until it reached 40 percent. The rule defined a two-year default rate: it measured the percentage of students entering repayment in one fiscal year who defaulted before the end of the following fiscal year.[3]

In December 1989, Congress enacted its own CDR limit, prohibiting the borrowing of supplemental loans (now unsubsidized loans) at schools with a single two-year cohort default rate above 30 percent.[4]

In November 1990, Congress expanded these restrictions, removing all student loan eligibility from colleges with three consecutive years of a two-year default rate above 35 percent in fiscal year 1991 and 1992 and 30 percent thereafter.[5] In 1992, Congress lowered the maximum rate to 25 percent beginning with fiscal year 1994.[6]

The new accountability regime caused many of the highest-risk schools to leave the student loan program and drove down national default rates.[7] The national CDR fell from 22.4 percent in fiscal year 1990 to 5.9 percent in fiscal year 2000. Over 1,000 institutions closed between 1991 and 2000, 80 percent of which were for-profit colleges.[8] Enrollment losses at for-profit colleges were almost entirely offset by increased enrollment at local community colleges.[9]

Use of the CDR over this time period demonstrated that schools can and do meaningfully reduce their default rates while also protecting access to loans. For example, a consortium of Texas Historically Black Colleges and Universities (HBCUs) with high default rates in 1999 pooled their resources and successfully reduced default rates through comprehensive default prevention efforts that included increased focus on retention and on-campus supports.[10] Research has also identified a number of strategies for reducing defaults at community colleges.[11] That students experience higher rates of default at some schools, even after controlling for demographic and other factors, underscores the role an institution plays in their students' risk of default.[12]

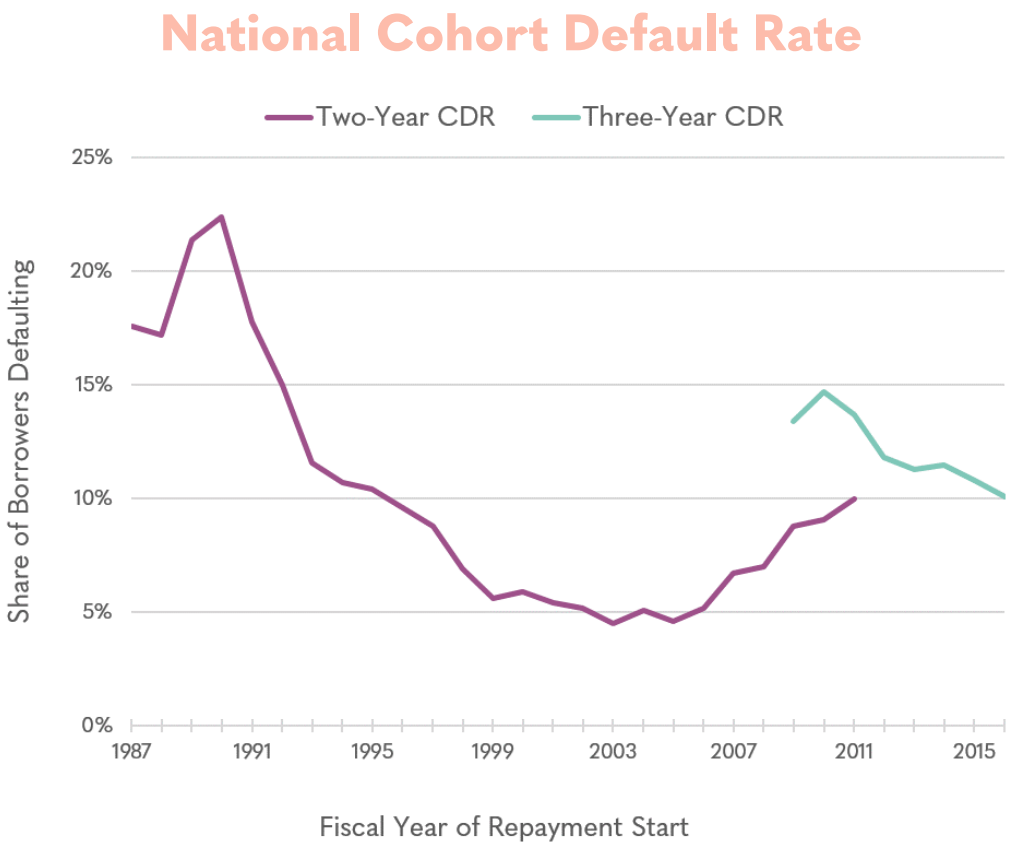
In 2003, the Department of Education's Office of Inspector General documented concerns over defaults occurring after the metric's two-year window.[13] The report identified that some colleges were encouraging students to use forbearance, which allows borrowers to temporarily suspend payments but – when misused – can merely delay student loan default while interest accrues (for more on forbearance abuse, see page 9).

In 2008, Congress responded by replacing the two-year CDR with a three-year CDR.

The new rule defined the CDR as the percentage of borrowers entering repayment who default before the end of the second subsequent fiscal year. At the same time, Congress raised the maximum allowable CDR from 25 percent to 30 percent.[14] Congress has not revisited the CDR metric and standards since.

After large scale declines in CDRs over the first decade of its use, default rates began rising again between 2000 and 2011, in large part due to the rapid growth of enrollment

of non-traditional students in low-quality colleges.[15] Since the move to the three-year CDR, rates have been in decline: three-year rates went from 14.7 percent for the fiscal year 2010 cohort to 10.1 percent for the most recent (fiscal year 2016) cohort.[16]



Source: Data from the U.S. Department of Education. http://bit.ly/33iSLsl and http://bit.ly/2X2dNcD.

Default Remains a Serious Concern for Borrowers and Taxpayers

For two decades after the CDR was introduced, default rates fell steadily, evidence of the metric's effectiveness in reducing defaults. But default continues to be a serious cause for concern for both individual borrowers and taxpayers.

Approximately 7.4 million borrowers were in default in October 2018.[17] A total of 1.2 million borrowers defaulted on their student loans over the past 12 months.[18] Nationally representative survey data show that 17 percent of students entering college in 2003 defaulted within 12 years, and risks of default are concentrated among specific groups of students. Low-income students, Black students, and students who are single parents are

at least twice as likely to default within 12 years of entering college. Nearly half (48%) of students who attend for-profit schools default within 12 years, four times the rate of their peers in public colleges.[19] Two-thirds (65%) of defaulters have incomes less than 200 percent of the poverty line, and over half (52%) have less than $10,000 in federal student loan debt.[20]

Upon entering default, a borrower's entire unpaid loan balance becomes due and accumulated interest is capitalized. In at least 18 states, a borrower's professional and driver's license may be suspended, further jeopardizing their economic livelihood.[21] Default damages a borrower's credit score, limiting a borrower's ability to make other financial investments and jeopardizing access to housing. Defaulting on a loan also creates barriers to returning to school or securing employment.[22] To collect the debt, the federal government can garnish a defaulted borrower's wages and withhold tax refunds and other federal benefit payments, which can put further financial strain on very-low-income borrowers who rely on these payments to make ends meet.

Default also takes a toll on taxpayers. In fiscal year 2018, $86.4 million in federal funding was spent on federal student loan collections through the Default Management Collections System.[23] In large part due to the government's strong forced collection powers, the Department of Education expects the vast majority of defaulted loans to be recovered, even after accounting for collection costs.[24] Even if these projections are proven correct over time, taxpayers are responsible for any amount of uncollected student loans, and money dedicated to collecting defaulted loans is money not available to invest in other public priorities.

Defaulted loans can create drag for national and local economies even if the borrower later returns to good standing. For example, licensure revocation can create barriers to participating in the workforce; damaged credit scores can create barriers to renting, home ownership, and car purchases; and defaulted borrowers and their families whose strained balance sheets force tradeoffs between meeting basic needs and resolving a defaulted loan may need to rely on taxpayer-supported public benefit programs.

Priorities for Strengthening the CDR

The CDR has worked to reduce the risk of default, yet time has also revealed shortcomings that must be addressed to strengthen the CDR accountability system and further reduce default risk. Efforts to improve the CDR system must begin with ensuring the measure itself is meaningful and protected from manipulation. In addition, policymakers should move away from an all-or-nothing system toward one that provides greater incentives for all colleges to continuously improve, and should reduce the maximum allowable CDR to drive further improvement.

Protect Against CDR Manipulation

Abuse of Forbearance Options

Over time, the integrity of the CDR metric has been called into question as a result of schools managing their CDR without meaningfully reducing their students' risks of default. Many schools use default management consulting firms, which can steer borrowers into long-term or consecutive periods of forbearance. While forbearance is an important tool to suspend payments and help borrowers avoid default in the short term, interest continues to accrue and borrowers may be at increased risk of defaulting in the future on an even larger loan balance. Some borrowers would benefit more from other repayment relief options more suitable for prolonged periods of financial hardship.

There is abundant evidence that some colleges evade CDR accountability by exploiting forbearance options that push defaults outside the time period for which a school is held accountable for defaults.[25] Most recently, an April 2018 Government Accountability Office report identified concerning patterns of default management firms misleading students into long-term forbearances that not only increase costs to the government but also bring severe financial consequences to borrowers.[26]

Income-Driven Repayment Is a Better Option for Borrowers Facing Extended Periods of Financial Hardship

While avoiding default is always in students' best interest, excess interest and later default on a higher balance is not. Forbearance can significantly increase the cost of a loan: all federal loans accrue interest while in forbearance, and this additional accrued interest is added to the principal loan balance at the end of the forbearance. Interest then compounds and the loans grow faster.

Forbearance can be appropriate for borrowers facing temporary financial hardship, but the law states that forbearance is intended to provide short-term repayment relief "for the benefit of the student borrower."[27] Long-term forbearance is, by and large, not in borrowers' best financial interests. Many borrowers placed in forbearance would be better served by enrolling in an income-driven repayment (IDR) plan, which can provide more affordable monthly payments, as low as $0 for borrowers with incomes below 150 percent of the federal poverty line (about $25,000 for a family of two). Borrowers in IDR plans are also less likely to be delinquent or default on their loans than those in a fixed ten-year plan.[28]

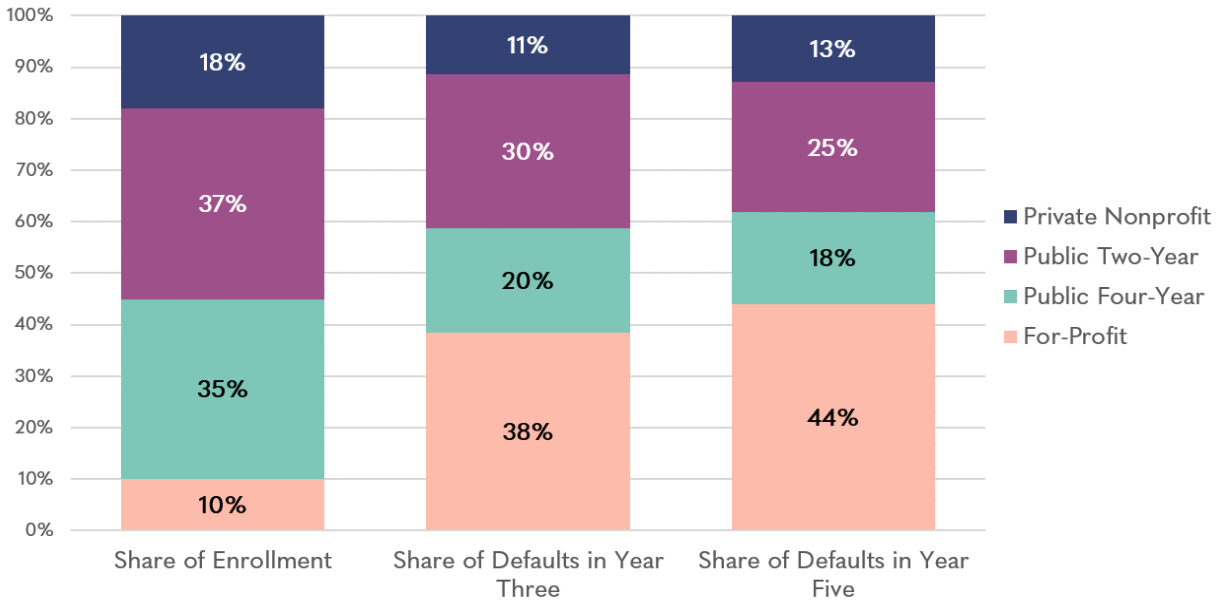
In the past, Senate investigators concluded that some colleges "appear to cross the line from default management to default manipulation," with efforts to prevent student default often halting soon after the period when schools are held accountable for defaults.[29] In 2011, the Department of Education accidentally released three-year rates reflecting 3.3 years' worth of defaults, and the number of institutions with three-year CDRs over 40 percent more than doubled compared to the correct rate.[30] More recently, data obtained by the Center for American Progress through a Freedom of Information Act request provide additional insight into the scope and variation in borrowers' risks of default over different periods of time.[31]

Not surprisingly, some borrowers default after the three-year accountability window, and they do so at different rates across different types of colleges. Across all schools, one in ten borrowers were in default three years after entering repayment in fiscal year 2012. By year five, 15.5 percent were in default.[32] The shares of borrowers at for-profit colleges in default increased from 14.6 percent by year three to 24.9 percent by year five. The CDRs increased from 18.1 percent to 22.8 percent at two-year public schools, from 6.5 percent to 8.6 percent at four-year public colleges, and from 5.0 percent to 8.5 percent at private nonprofit colleges over the same period.

While two-thirds of borrowers who were in default by year five defaulted within the three-year CDR window, across all schools, the number of borrowers in default increased by 49 percent in the following two years. In this period, nearly 280,000 borrowers experienced default while their school did not experience any consequences for that default. As with three- and five-year default rates, percent increases in the number of defaulters vary by college type, ranging from 26 percent at two-year public schools to 71 percent at for-profit colleges.

Within the three-year CDR window, for-profit colleges account for a disproportionate share of defaults, and by year five the disproportionality grows. For the year of data explored, for-profit colleges accounted for 10 percent of enrollment, 38 percent of defaulters in year three, and 44 percent of defaulters in year five. In contrast, public two-year colleges accounted for 37 percent of enrollment, 30 percent of defaulters in year three, and 25 percent of defaulters in year five.

Disproportionate Loan Defaults Compared to Enrollment



Source: Enrollment figures come from U.S. Department of Education, IPEDS 12-month unduplicated headcount for all students enrolled in 2013-14 in schools in the 50 states plus DC. Default figures refer to borrowers entering repayment in fiscal year 2012, who default by fiscal year 2014 or 2016. Default figures come from U.S. Department of Education data received through a FOIA request by the Center for American Progress.

While growth in default rates can be expected over longer periods, a particularly large spike in default rates after the three-year CDR window may indicate troubling patterns of forbearance abuse. Over 9,100 borrowers experienced default in the two years following the accountability window after attending one of just 50 schools that had five-year default rates in excess of triple their three-year rates.[33] On average, 8.4 percent of borrowers at these schools were in default at the end of the period for which the school is accountable; by year five, 30.5 percent were. More than two-thirds (70%) of these 50 schools saw rates increase by at least 20 percentage points.

Some have suggested changing the calculation of the CDR itself to address forbearance abuse. Under this approach, borrowers in some extended period of forbearance could be reclassified as in default for the purposes of the CDR calculation, moved into a later cohort to adjust for months spent in forbearance, or both.[34] However, reclassifying long-term forbearances as default would make problematic equivalencies between two different loan statuses, altering the meaning of the CDR and limiting the metric's ability to fulfill its purpose. Forbearance is an active repayment status (in which payment requirements are temporarily suspended) while default comes with immediate, significant financial consequences. Protecting the CDR against forbearance abuse remains key to

strengthening the CDR's ability to clearly and meaningfully measure the rate of absolute repayment rock bottom. At the same time, a range of additional metrics, including different constructions of non-repayment calculations, are needed to understand a broader array of risks of poor borrowing outcomes.

Another approach to addressing forbearance abuse is to count certain borrowers in the cohort year in which they exited forbearance, rather than the year in which they entered repayment. However, this approach raises a number of methodological complications, the potential loophole of never measuring borrowers moving in and out of long periods of forbearances, and ambiguity that undermines the CDR's ability to convey comparisons across years. Reassigning borrowers in some period of forbearance to a later cohort would create inconsistent CDR cohorts that measure outcomes of borrowers who entered repayment in different years and therefore combining borrowers who have been in repayment for different periods of time. This approach would also potentially shift defaults to later cohorts, impairing the ability of the system to impose relatively timely consequences based on a comparable group of borrowers.

The most effective way to reduce forbearance abuse is to ensure that forbearance is always used in the borrower's best interest, as is already required by statute.[35] Greater transparency of longer-term default rates can identify patterns of abuse, and the Department of Education should respond to unusual spikes in defaults outside the three-year window with an immediate investigation into possible CDR evasion, a program review, or an audit. Investigations should include a determination of whether forbearances were, in fact, generally made in the best interest of the borrower. While the Department of Education has authority to take these steps, Congress can and should compel these actions if the Department declines to act on its own.

Recommendations to Address Forbearance Abuse

- *Amend current regulations to ensure that forbearance is "for the benefit of the student borrower," not for the benefit of schools*. Section 428(c) of the Higher Education Act specifies that contracts "may, to the extent provided in regulations of the Secretary, contain provisions that permit such forbearance *for the benefit of the student borrower* as may be agreed upon by the parties to an insured loan and approved by the insurer" (emphasis added). Regulations should be strengthened by specifying that certain types of forbearance patterns — such as back-to-back forbearances — are rarely to borrowers' benefit and requiring that schools and servicers document the reasons why an additional forbearance is the best solution for the borrower. This rule modification recognizes the importance of forbearance as short-term relief but prioritizes solutions better suited for longer-term periods of financial hardship.

- *Publish five-year default rates in the interests of transparency, in addition to the three-year rates used for accountability*. While the government has a strong interest in holding colleges accountable for high risks of default occurring relatively quickly after entering repayment, longer-term default rates are critical for identifying where forbearance abuse may be delaying, rather

than preventing, defaults. However, these data are not routinely publicly available, and the Department of Education is not currently required to calculate or review these data.

- *Target program reviews or other investigations at colleges with significant increases in default rates after the three-year window closes*. As part of a program review or investigation triggered by spikes in default rates outside the accountability window, the Department of Education should be required to determine whether the school has documented that forbearances are provided for borrowers' benefit. Investigations could also be triggered by high rates of consecutive forbearances as identified through more routine data analysis, program reviews, and audits.

CDR Evasion Through OPEID Manipulation

The Department of Education calculates a CDR for each institution, as identified by a unique six-digit Office of Postsecondary Education Identification (OPEID) number. However, some schools have multiple six-digit OPEIDs, and they can and do shift campuses to different OPEIDs and classify them as branches regardless of their geographic proximity, even when they are located in several different states. The Department defines CDR evasion as "an attempt to avoid cohort default rate sanctions by changing a school's name, location, corporate structure, OPEID, or other status."[36] Investigations have demonstrated that some schools consolidate OPEIDs or open branch campuses as a means of masking CDR problems and remaining under the allowable threshold.[37]

Recommendation to Address OPEID Manipulation

- *Require colleges seeking to make changes to their OPEID structure to comply with CDR rules under both their new and old OPEID structures for at least three years after the change, with sanctions applying upon noncompliance of either.*

Build in Greater Incentives for Schools to Improve Their CDRs

Over the last five years, 46 schools appeared on at least one of the Department of Education's annual list of schools subject to CDR sanction as a result of an unacceptably high CDR (between 10 and 15 schools each year). The fact that so few schools hit sanction levels can be a reflection of the system's success at reducing defaults below the threshold. Yet for thresholds to provide meaningful incentives, they have to entail meaningful consequences. CDR policy includes a variety of challenges and appeals which collectively promote the integrity of the system, ensuring that data used are accurate and that schools are not held to unreasonable standards.

While public data on CDR appeals is rare, available data suggest that the economically

disadvantaged appeal is particularly common among schools with high CDRs. The option is intended for use by schools that enroll predominantly low-income students and serve them well, as measured by job placement rates for non-degree-granting schools and graduation rates for those that grant degrees. For the fiscal year 2012 rates, nine of the 15 schools on that year's sanction list submitted an economically disadvantaged appeal; all nine were for-profit colleges. Seven such appeals were granted, all but one of which were to non-degree-granting schools.

Data from a FOIA request of The Century Foundation and the Department's own CDR public database suggest that economically disadvantaged appeals are often used in consecutive years when the school continues to appear on the annual sanction list. For instance, there were five schools on the fiscal year 2016 sanction list that had also appeared on at least one of the three prior years' lists; four of these five had been granted an economically disadvantaged appeal for at least one of the prior three years. Two of these colleges had a CDR over 50 percent. With more than half of borrowers defaulting soon after leaving school, these schools may enroll disadvantaged students but they are not serving them well. Moreover, the misrepresentation of job placement rates has been well documented.[38] Given the importance of meaningful thresholds to a well-functioning accountability system, it is worth exploring the continued utility of this appeal and whether stronger safeguards are needed to prevent abuse.

It may be appropriate to consider extenuating circumstances in some cases to ensure that the CDR does not deny access to financially vulnerable students. However, the persistence of exceptionally high rates of default at a handful of schools serving these students remains alarming. If legitimate appeals options exempt these schools from harsh consequences, more tolerable consequences imposed at lower thresholds are appropriate and needed to lower default risk across the board.

The CDR's current approach gives colleges a strong incentive to avoid crossing a single threshold but offers little external motivation for schools to continuously strive to further reduce their students' risk of default. An analysis of institutions' CDR changes between fiscal year 2012 and fiscal year 2016 shows that, while many schools' CDRs have improved over the last three years, many have not.

Fiscal year 2016 CDRs declined from fiscal year 2014 rates at over half (58%) of colleges.[39] These schools' CDRs declined by an average of about 28 percent. Between fiscal year 2014 and fiscal year 2016, CDRs at nine percent of schools decreased by over 50 percent. At the same time, about one in four (19% or 830) colleges' fiscal year 2016 CDRs increased over fiscal year 2014 rates by at least 25 percent, and ten percent of (449) schools had fiscal year 2016 CDRs that were at least 50 percent higher than fiscal year 2014 rates.

There are currently few consequences for schools with CDRs below the threshold at which schools lose access to Title IV aid. After a single year of a CDR equal to or greater than 30 percent, a school must develop and submit to the Department of Education a default management plan. If the school has a second consecutive year with a CDR at

or above 30 percent, the school must revise that plan and submit it for review by the Department of Education again.[40] Schools with three consecutive CDRs of 15 percent or more are not permitted to disburse federal student loans in a single installment and must delay, by 30 days, disbursements to first-time first-year borrowers. Schools with a CDR of five percent or more cannot provide their study abroad students a single student loan disbursement.[41]

In order to better incent continuous progress in reducing CDRs, Congress should introduce meaningful interim consequences for schools with CDRs falling below the maximum allowable threshold. Some policymakers and higher education policy advocates, including TICAS, have proposed introducing some form of "risk sharing" payments that hold colleges financially responsible for a share of the cost of negative student loan outcomes.[42] Financial penalties can be less severe than loss of Title IV aid eligibility and can be adjusted by a measure of default risk. Yet, questions remain about the viability and impact of such a system, particularly for persistently underresourced colleges, and any risk sharing system would need to be approached with utmost caution in order to avoid unintended outcomes.

A range of other interim consequences are worthy of exploration. While graduated sanctions hold promise for ensuring that consequences of different CDR thresholds are proportional to students' risk of default, policymakers should also explore the use of rewards and other positive approaches, including providing underresourced schools additional resources to support meaningful improvement in their CDRs.

Options for Interim Consequences for High CDRs

- *Earlier, enhanced default management plan*. Because CDRs measure cohorts of borrowers over a three-year period, their measurement takes time. Requiring colleges to develop and implement a default management plan at the point when defaults reach unacceptably high levels means that default reduction strategies are not in place to support borrowers in immediately subsequent cohorts. For instance, by the time a college receives its fiscal year 2012 CDR in 2015, borrowers included in its fiscal year 2013 and fiscal year 2014 have already entered repayment and perhaps already defaulted. Congress should require colleges to submit plans well before CDRs reach sanction thresholds, and their implementation should be actively monitored by the Department of Education.

- *In-person loan counseling for first-year students*. All first-time borrowers are required to complete loan counseling that provides key information about borrowing options and obligations, including the availability of income-driven repayment plans that can reduce default risk. Colleges can use the free online tool made available by the Department of Education to meet the counseling requirements. While the Department has worked to improve the clarity and personalization of this tool, requiring higher CDR schools to deliver counseling in person could increase a school's dedication of resources to student supports

and provide better-tailored counseling to address campus-specific challenges. In-person counseling is also better positioned to integrate other more personalized supports, including additional information about federal means-tested benefits, academic advising opportunities, and other support services available on campus that can increase student success.

- *Student warnings*. Schools with high CDRs can also be required to provide current and prospective students with warnings that include the school's three most recent CDRs, the share of students borrowing, and consequences of student loan default. Warnings should prominently appear on a school's website as well as be delivered electronically to all admitted students, as well as enrolled students.

- *Default-focused program reviews*. Schools with high CDRs could be subject to more frequent program reviews that identify drivers of default at an individual school, action steps needed to reduce default, as well as other areas of focus already included in a program review. Current law requires the Department of Education to give priority in program reviews to schools with high cohort default rates, but the Department does not complete program reviews on an annual basis and there is no requirement that it review schools with a high CDR.[43] The Department should conduct a program review during, at minimum, the year following a CDR that exceeds a very high threshold, that is lower than required for student aid eligibility.

Lower the Maximum Allowable CDR

In using a 30 percent CDR eligibility threshold, the federal government signals that it is acceptable for large shares of borrowers to quickly default after leaving school. There are established practices by which colleges can reduce their default rates further, and many – but not all – schools do so. The enactment of CDR rules helped drive down default rates steadily for nearly two decades, and a lower threshold could help continue that progress. A lowered threshold would also better account for the impact of student loan repayment policy changes that separately reduce default risk.

Since the three-year standard was introduced for borrowers entering repayment in 2012, the number of direct loan borrowers enrolled in an income-driven repayment (IDR) plan increased from 1.6 million to 7.7 million.[44] IDR plans reduce the risk of default by providing more affordable monthly payments that can be as low as zero for the lowest income borrowers, and growing enrollment in these plans may have contributed to the decline in CDRs. The successful enactment of a bipartisan proposal to automatically move severely delinquent borrowers into income-driven repayment plans could further reduce default rates without colleges improving student achievement or affordability.[45] The potential role of IDR in declining default rates reflects real lowered risks of default within three years of entering repayment, but makes it no less important to continue tracking where high risks of default persist. In fact, high default rates are all the more concerning in light of

available repayment protections that reduce that risk.

Ensure the CDR Effectively Targets High-Risk Colleges

As Congress reconsiders an appropriate maximum allowable CDR, it must also work to ensure the CDR effectively captures the risk a college poses to its students. The current CDR is a measure of the risk a *borrower* will default, because the rates include only those students who borrow federal loans. But the share of students who borrow varies from college to college. The risk that any *student* at a school will default is the product of both the school's borrowing rate and its default rate.

A student-based metric, rather than a borrower-based one, would more accurately identify colleges where students are at the greatest risk of default. For example, a similar share of *borrowers* default at community colleges and for-profit colleges, but the likelihood of a *student* defaulting at a for-profit college is three and a half times higher than at a community college.[46]

Under current law, the Participation Rate Index (PRI) is an appeal option that can exempt from sanction schools with very low borrowing rates and is designed to ensure the CDR is a fair judge of risk to students. Yet, the PRI appeal process is complex and opaque, and it can discourage federal loan program participation at community colleges.[47]

To more efficiently and transparently target colleges posing high risk to their students, a school's borrowing rate should be accounted for in the CDR itself. In absence of moving to a student-based default risk metric, any adjustments to the CDR thresholds should be accompanied by an adjustment to the participation rate threshold.

Conclusion

No student should face a reality in which borrowing to cover the cost of college results in being worse off than had they not pursued education at all. Following the introduction of the CDR accountability system three decades ago, the federal government continues to have a strong interest in preventing colleges from consistently leaving their borrowers with unacceptably high risks of default. The serious consequences of default on borrowers and the larger economic impacts of default make it imperative that schools remain focused on preventing this worst borrowing outcome. As policymakers continue working to help more borrowers stay current on their loans, they must strengthen the CDR system to further reduce defaults.

An effective CDR accountability system requires shared standards of default risk that give all schools a compelling reason to meaningfully reduce defaults. To that end, the CDR system has effectively focused schools on avoiding the established standard and reducing their CDRs over time. An effective CDR system also requires a metric that clearly and effectively measures that risk, with protections against manipulation to ensure schools who are responding to established thresholds are doing so for the benefit of borrowers

rather than to evade accountability.

Both the Department of Education and Congress can act to modernize the CDR system, providing greater protections against CDR manipulation and enhancing the metric's ability to measure default risk. The CDR system should also incorporate a range of interim consequences to move away from the current all-or-nothing approach that falls short of ensuring all schools continuously work to reduce default risk. Policymakers should also revisit baseline standards to reflect policy changes that have independently worked to reduce default, and Congress should ensure that the CDR effectively targets high-risk colleges.

More than one million students default every year, often with devastating consequences. The cohort default rate is a longstanding bipartisan protection against unaffordable debts that has been proven to work. Congress and the Department of Education should modernize this tool to better protect students and taxpayers from unaffordable debts.

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