Student Borrowing in America: Metrics, Demographics, Default Aversion Strategies

By Frank Kesterman

Frank Kesterman is a consultant in the Washington DC area. He formerly served for the Department of Education in the office of Federal Student Aid.

The use of Cohort Default Rate (CDR) as the primary measure of student loan defaults among undergraduates was investigated. The study used data extracted from the National Student Loan Data System (NSLDS), quantitative analysis of Likert-scale survey responses from 153 student financial aid professionals on proposed changes to present metrics and methods, and anonymous, qualitative interviews with 12 notable scholars and experts about default aversion strategies. A sample of defaults over eight years revealed a default rate of 17.91%, or almost double the published two-year CDR of 9.6% for the 1996 cohort. Further, the actual average default rate for the entire student loan portfolio was found to be 13.65%, or 2.44 times higher than a point-in-time CDR of 5.6% as of September 30, 2002, suggesting limitations of the CDR as the sole loan portfolio measurement tool. Additionally, there is dissatisfaction with the present 25% default rate ceiling required for schools to maintain institutional eligibility to participate in the Title IV federal student aid programs. Entire school groups exceeded the 25% default ceiling when viewed over eight years. The study also found strong support for greater utilization of loan guaranty agencies in default aversion instead of debt collection.

The study concludes that economic and demographic changes taking place in higher education over the period 2001-2015 necessitate increased funding for outreach programs to educate low-income and minority at-risk populations on the availability of federal student aid, student loan repayment options, and the consequences of default. Other recommendations of the scholars and experts interviewed for this study include re-engineering default management and school performance measures, forming a national task force focused on finding affordable higher education approaches for the at-risk groups, and initiating a study of expanded debt forgiveness for critical occupations such as teaching, health care, and civil protection.

As of September 30, 2003, there were 5,582,494 Americans in default (NSLDS, 2003) and many more are carrying very large student loan debt burdens that might contribute to the risk level of the federal student loan portfolio. The growing burden of student borrowing calls into question the personal benefits model that assumes that Americans will continue to borrow to finance their postsecondary education as an investment in their future. David Ward, president of the American Council on Education, expressed concern about the financial health of academe when commenting on tuition increases.

There are "very serious long-term issues in financing higher education that ultimately threaten the social compact that has served students and families so well for more than 50 years" (Hoover, 2004, p.1).

Debt burdens need to be better understood in human and statistical terms in order to devise default aversion options that work (Kesterman, 2003). A recent report titled "Burden of Borrowing," published by the Higher Education Project of the State Public Interest Group in 2002 and based on the U.S. Department of Education's 2000 National Post Secondary Student Aid Study, found that an estimated 39% of student borrowers are graduating with "unmanageable debt," which is defined as debt in excess of 8% of borrowers' gross monthly income. In addition, 55% of African-American student borrowers and 58% of Hispanic student borrowers graduated with unmanageable debt burdens (King & Bannon, 2002).

Attitudes toward borrowing appear to be changing. In the 2002 National Student Loan Survey sponsored by Nellie Mae, only 59% of students agreed that the benefits of incurring student loans are worth it. Another 20% were neutral (Baum & O'Malley, 2003). Compared with other surveys, this was the lowest percentage to agree that the benefits of student loans are worth the debt burden. The earlier percentages of students who gave this response were 66% in 1997, 74% in 1991, and 68% in 1988 (Baum & O'Malley, 2003). These statistics suggest that the limits of the personal-benefit model are being tested. When predicting the future health of higher education, those in academe should monitor carefully shifts in the assumption that the benefits of higher education still exceed the costs of student loan borrowing. To place the importance of this topic in perspective, Fossey and Bateman state: "It can be argued that appreciably higher student loan levels represent almost as significant a development in federal aid policy as the GI Bill or the original Higher Education Act of 1965" (Bateman, & Fossey, 1998, p. 71).

To help advance the understanding of debt burdens and effective default aversion strategies, study examines the use of the Cohort Default Rate (CDR) as the principal metric for assessing student loan defaults in a time of increased borrowing to meet escalation in the cost of postsecondary education. A major inspiration for this research was the Student Loan Repayment Symposium, held in October 2000. This study builds on the recommendations of that symposium (Woods, 2001).

Archival Data Analysis

By analyzing NSLDS data queries, this study established trends in student borrowing and defaults (NSLDS, 2003). NSLDS, operated by contractors for the U.S. Department of Education (ED), is the central data system that tracks all federal student loans and Federal Pell Grants. As of October 2, 2003, NSLDS contained records on 165,197,525 loans held by 50,131,888 borrowers.

Records cover borrowers who are in grace period, repayment, deferment, forbearance, or default. Student borrower records are maintained in NSLDS for up to 30 years, until the loans are paid in full, or until the debt obligation has been relieved through death, permanent disability, or personal bankruptcy.

Access to NSLDS records to support this research was obtained under the Freedom of Information Act (FOIA) (NSLDS, 2003). Specifically, defaults for the 1996 sample cohort of 2,197,188 borrowers were tracked for eight years, from 1996 through 2003, and compared with aggregate national cohort default rates published by ED for the same 1996 cohort. Using the FOIA sample, student loan defaults of the 1996 sample cohort over eight years were found to be 17.91%, compared to the two-year CDR of 9.6% published by ED for the 1996 cohort.

The understatement of the loan default problem by using the CDR is also supported by data from the Office of Management and Budget (OMB). OMB uses credit-subsidy models for making estimates of subsidies for all government loan programs, as required under the Credit Reform Act of 1990. By law, the budget for ED and the Budget of the United States provide estimates of loan lifetime default rates and subsidy expense by school type, grouped by risk categories. Student loan default rates from the 2004 Budget of the United States (Budget, 2004) were used as a benchmark and found to be consistent with NSLDS queries of the fiscal year (FY) 1996 cohort in contrast with published CDRs.

Table 1
Baseline Portfolio Trends

	Dollar Amount of Student Loan Principal and Interest Outstanding, in Billions	Dollar Amount of Loan Balances in Default, in Billions	Percentage of Amount in Default	Number of Borrowers in Default	Percentage of Borrowers in Default
4th 1999	230.5	28.9	12.55	6,189,990	17.11
1st 2000	237.7	29.0	12.18	6,206,012	17.01
2nd 2000	242.6	28.4	11.72	6,259,922	17.06
3rd 2000	250.9	28.6	11.38	6,262,103	16.70
4th 2000	253.0	27.8	11.00	6,251,157	16.52
1st 2001	261.0	29.4	11.26	5,781,083	15.16
2nd 2001	263.8	28.6	10.85	5,383,861	14.03
3rd 2001	275.5	29.7	10.79	5,821,160	14.81
4th 2001	279.4	29.9	10.71	5,829,309	14.67
1st 2002	289.3	30.8	10.65	5,752,323	14.35
2nd 2002	292.9	30.9	10.56	5,587,553	14.30
3rd 2002	302.8	31.5	10.40	5,616,463	13.65
4th 2002	309.6	32.1	10.36	6,118,409	13.27
1st 2003	321.4	32.2	10.03	5,601,388	13.22
2nd 2003	328.3	32.8	9.99	5,574,920	13.02
3rd 2003	335.6	32.7	9.78	5,582,494	12.81

Source: NSLDS, 2003.

Table 1 presents statistics from the NSLDS showing actual data trends.

These NSLDS data (NSLDS, 2003) represent the loan portfolio as a whole, indicating a favorable trend: the percentage of students in default over time has been declining from 17% to 12.8%. In contrast, the CDR, which is also declining over time, is based on borrowers who entered repayment and defaulted in that year or the following year. To illustrate the relevancy of the CDR as an indicator, the FY 2002 CDR, which corresponds to the third calendar quarter of 2002 (the period ending September 30, 2002), was 5.6%. At that time the percentage of students in default for the entire portfolio was 13.65%, or 2.44 times higher than the CDR on that date. Hence, the limitations of the CDR as a measurement tool should be understood in the proper context as a short-term trend indicator.

Quantitative Research

Data collection began with a Likert-scale survey questionnaire sent to the members of the National Association of State Student Grant and Aid Programs (NASSGAP), and the National Council of Higher Education Loan Programs (NCHELP). The combined importance of these two organizations as sources of expertise provides significant credibility to the survey results. NASSGAP has published its annual survey of state-sponsored student financial aid programs for 36 years. Its members are the higher education officers drawn from single agencies in each state and territory of the United States responsible for state-funded student aid. NCHELP represents hundreds of lenders, guaranty agencies, schools, loan servicers, collectors and secondary markets involved in the administration of the Federal Family Education Loan Program (FFELP).

NCHELP's Debt Management Committee and Financial Aid Professionals Committee collaborate with the NASSGAP Research Committee and collectively with the NASSGAP/NCHELP Research Network. The NASSGAP/NCHELP Research Network has deliberated for 21 years on common student financial aid policy issues such as access, affordability, and persistence, all of which involve federal and state financial aid programs. The NASSGAP/NCHELP research population of 270 practitioner experts constitutes a diverse group of researchers without a common political agenda and thus is an ideal population for a quantitative survey on student financial aid.

Responding to a formal request to use the organization's mailing list, NASSGAP/NCHELP Research Network Chairman Jerry Sheehan Davis, former vice president for research at the Lumina Foundation, stated:

> Over the 21 years of meetings, the network grew to include college faculty members, Washington education association representatives, staff from state and regional

> education associations, Department of Education staff, an occasional legislator, loan service bureau employees and consultants. It is a very diverse group, held together by their common interest in sharing knowledge on student financial aid and access related issues. Each of the conferences has featured presentations on loan issues. Almost all of the events have had at least one presentation on student loan default issues. For all these reasons, I was confident that the network mailing list would include everyone in the nation who had any level of expertise in your dissertation topic (J.S. Davis, personal e-mail communication, December 10, 2004).

This core population of 270 people was expanded through the cooperation of the separate NCHELP Debt Committee to create a total sample population of 431. The NCHELP Debt Management Committee is comprised of officials and executives of the student loan guarantee agencies, state student financial aid assistance commissions, FFEL lenders, debt collection agencies, and FFEL student loan servicing companies. The chair of the NCHELP Debt Management Committee endorsed the survey questions and sent the survey directly to the members of the committee, recommending voluntary participation. Other NCHELP members were randomly selected based on their job titles having management responsibilities for default aversion.

Others not associated with the NASSGAP/NCHELP Research Network also participated. These included representatives of student financial aid associations and present and former officials of the U.S. Department of Education with student financial aid experience up through the rank of Assistant Secretary of Education. Roughly 35% of these individuals (153) responded to the survey, which was conducted by e-mail. The survey provided statements to which the respondents indicated their level of agreement: strongly agree, agree, neutral, disagree, or strongly disagree. The questions were developed after a round of discussions with a focus group of leaders in the financial aid field, and were field tested on a group of 21 financial aid professionals. The field test successfully achieved a Cronbach's alpha reliability factor of 0.728 (UCLA, 2004).

Qualitative Research

An explanatory mixed-method approach was used to capture the best of the quantitative and qualitative research designs. The quantitative data was collected first. The qualitative data was then collected and used to help explain or elaborate on the quantitative results. Qualitative data was used to refine the quantitative results by exploring a few issues in-depth, probing key findings and seeking an explanation for the lack of consensus on a certain policy question.

For the qualitative part of the analysis, 12 notable experts and scholars were interviewed. Each of these individuals met the following criteria:

- Holds or has held high positions in the field of student financial aid policy;
- Has published a number of authoritative reports and is a recognized authority in student aid literature; and
- Has worked for ten or more years in the field of student financial aid policy, teaching, research, student aid infrastructure industries, or government.

The notable experts and scholars selected and interviewed included a president of a student financial aid association; an independent financial aid witness for congressional committees; a leading default aversion executive at a state guaranty agency; a director of student financial aid at a large private university; a director of research at a financial aid industry association; a member of the Student Financial Aid Advisory Commission; a recognized federal student financial aid official; a representative of the FFEL lending community; a representative of the career college community; a representative of the state and community college system; a government relations executive for a large student loan lender/service organization; and a senior executive with a student loan collection agency.

Interviewees were asked open-ended survey questions relating to the Likert-scale issues to elicit their views on the history leading up to the current policy and their thinking on the refinement of policy improvements suggested by the quantitative survey. The interview elicited recommendations for legal, regulatory, and management changes that appear to offer new solutions or improvements in practices and policies. The Likert-scale survey findings and the in-depth interviews provide the basis for recommendations on student loan borrowing, debt burdens, and default issues.

The FY 1996 NSLDS Cohort

The official FY 1996 CDR was 9.6% for 2,423,286 students who were in repayment and who defaulted in that year or the following year. After eliminating foreign schools and small programs such as one-year proprietary schools, a sample cohort of 2,197,188 FFEL, Federal Direct (FDLP), and Federal Perkins Loan borrowers was used for analysis (NSLDS, 2003). The FY1996 CDR for the 2,197,188 borrowers in the sample was 8.06%, which is actually lower than the published 9.6% CDR. Table 2 shows that 393,623 borrowers defaulted through FY 2003, or 17.91% of the 2,197,188 borrowers in the cohort. The greatest number of defaults occurred in the second, third, and fourth year after entering repayment.

A review of the data indicates that the longer the default rate measurement period in the life of loans, the higher the default rate for the overall cohort. In this sample, the number of borrowers who actually defaulted by the end of the eighth year was 17.91, or more than double the 8.06% cohort default rate calculated for the first two years of repayment.

Table 2
Cohort FY 1996 Defaults, by Fiscal Year

Fiscal Year	Years in Repayment	Number of Defaults
1996	1	37,086
1997	2	139,990
1998	3	79,969
1999	4	43,523
2000	5	29,770
2001	6	29,840
2002	7	21,704
2003	8	16,044
Total defaults		393,623
Total number of borrowers in the FY96 cohort		2,197,188
Percentage of borrowers in the FY96 cohort who defaulted		17.91%

Source: NSLDS, 2003.

The sample also indicates that the second, third, and fourth years of repayment constitute a high-risk period over the life of loan. Clearly, the second year is the peak in the risk profile. This finding also supports the use of the CDR as a useful short-term risk indicator that would be even more useful if it were extended to four years, as recommended by the qualitative survey results. The risk relationship over time holds true for individual school types. As shown in Table 3, several categories of schools exceeded the 25% ceiling in the 8-year view.

Figure 1 and Figure 2 show that default curves are steepest in the first 4 years, with the second year being the peak for defaults. By the fifth year, proprietary associate's degree, proprietary post- graduate, proprietary bachelor's degree, and public associate's degree have crossed the 25% default line as a category of schools. Default rates are much higher for two-year schools than for four-year schools.

Analysis of Likert-Scale Survey Questions

The 153 respondents to the Likert-scale survey questions represent virtually every constituency with an interest in the future of student financial aid. Responses were received from university and college student aid administrators; professors; deans of schools; presidents and executives of educational associations; student consumer groups; career schools; lenders; rating agencies; state guaranty agencies; default aversion specialists; debt collection specialists; noted authors and consultants; advisory commission members; and government student aid officials up through the rank of Assistant Secretary of Education.

A summary of the distribution of responses to the survey is shown in the Appendix.

Statement 1: The individual Institutional Cohort Default Rate and the aggregate federal loan portfolio default rate would be more valuable as performance measures if extended over a longer time period in phases beginning with an initial 4-year measurement period from the time of entering repayment.

The survey found that 81.7% of the respondents strongly agree or agree with Statement 1. About 13.1% of the respondents strongly disagree or disagree with this proposal, and the remainder (5.2%) was neutral.

This overwhelming support for longer timeframes for observing defaults confirms earlier reports on this issue. At the Student Loan Repayment Symposium (hereafter, the Symposium) held in October 2000, financial aid professionals concluded that the 2-year cohort default rate window was not representative of actual default experience over longer periods. They reported, "Rates are roughly double the 2-year cohort rate" (Woods, 2001, p. 8). There was also support at the Symposium for measuring the life of loan default rates.

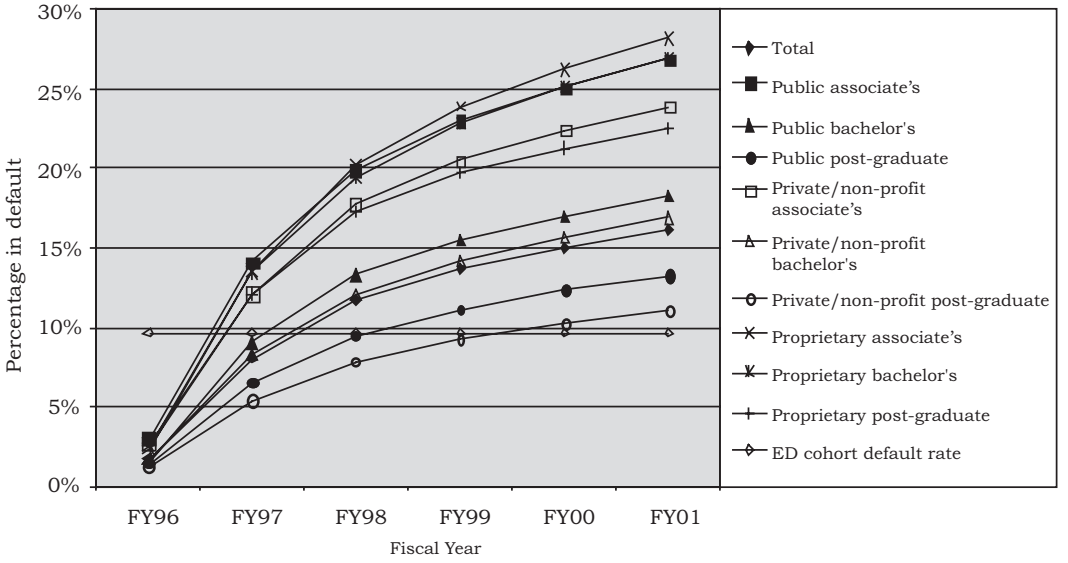
The question of lifetime default rates raises the issue of how long schools should be held accountable for students who default after graduating or leaving school. One expert interviewed at an education association put forward the notion of extended institutional responsibility for student loan repayment:

Table 3
Students Entering Repayment During the 1996 Cohort Year and Entering Default During 1996 or Subsequent Years, Through FY 2002

School Type	Program Length	Number of Students in Repayment	Number of FFEL and Federal Perkins Loan Defaults	Number of FDLP Defaults	Total Defaults	Rate
Public	Associate's degree	261,817	69,392	4,602	73,994	28.26%
Public	Bachelor's degree	37,525	6,408	984	7,392	19.70%
Public	Post-graduate	950,690	112,144	28,506	140,650	14.79%
Private/non-profit	Associate's degree	18,543	4,386	98	4,484	24.18%
Private/non-profit	Bachelor's degree	122,221	19,187	2,604	21,791	17.83%
Private/non-profit	Post-graduate	570,254	58,429	8,048	66,477	11.66%
Proprietary	Associate's degree	134,927	36,018	4,846	40,864	30.29%
Proprietary	Bachelor's degree	76,292	18,240	4,226	22,466	29.45%
Proprietary	Post-graduate	24,919	5,221	500	5,721	22.96%
All Types		2,197,188	329,425	54,414	383,839	17.47%

Source: NSLDS, 2003.
Note: Total defaults reported in Table 3 above is lower than total defaults in Table 2 because Table 3 uses seven years of data thru FY 2002, whereas Table 3 uses eight years of data thru FY 2003.

Figure 1
Incremental Increase in Default Percentage Rate Over Time for Students with Repayment Data Within FY 1996 who Enter Default in that Year or in Later Years, Through FY 2001, by Program Type



Source: NSLDS, 2003

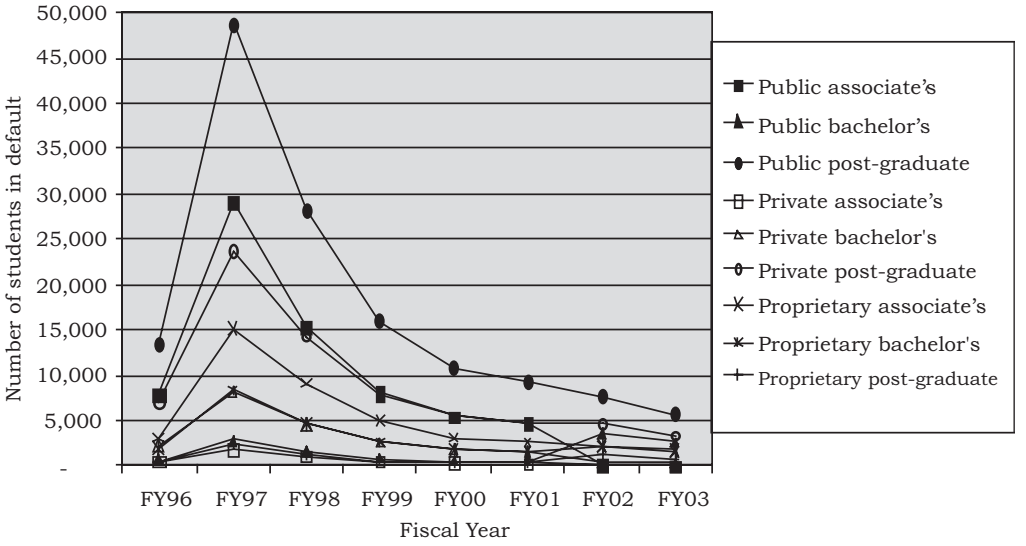
In repayment, because schools benefit from the tuition paid from the student loan asset, they have implied liability to make sure the student can repay loans through successful education leading to employment. Of course this is difficult to enforce on the school or the lender if the default occurs after several schools and/or several career changes.

The period that schools may have implied liability for student loan defaults is debatable. Currently, ED holds schools accountable for student loan defaults after the students leave school, and this is not likely to change because the schools have been very responsible in helping students understand their responsibilities as borrowers. Lenders are not held accountable to ED to the same standard as schools because the offering of federal student loans is a federal entitlement.

Statement 2: From a risk management perspective, and the perspective of taxpayers, dollars in default is highly relevant to monitoring dollar losses associated with loan programs. In addition to the Cohort Default Rate measure, dollar balances in default should be tracked by the Department of Education as a second default measure.

More than 80% of the respondents strongly agreed or agreed with Statement 2. This approach is consistent with a recommendation of the 2000 Student Loan Repayment Symposium:

Figure 2
Students With Repayment Data Within FY 1996 Who Enter Default in That Year or in Later Years, by Fiscal Year



Source: NSLDS, 2003.

> Dollars in default is a clear performance measure that we can use to determine how well we are doing. All schools, lenders, servicers, debt collectors and the Department of Education can work together to reduce dollars in default.... This would mean that resources currently needed to comply with the strict regulatory requirements could be redirected or targeted to those borrowers who need the most support. In other words, let's focus our efforts where they will be most effective in preventing defaults (Woods, 2001, p. 8).

Statement 3: The one-size-fits-all ceiling of 25% is out-of-date as the lone measure for excessive cohort default rates subject to sanctions or loss of Title IV eligibility. The single ceiling should be replaced with peer group benchmarks, some with higher or lower ceilings set according to peer group experience, i.e., four-year colleges, two-year colleges and proprietary schools.

Of the respondents. 61.5% agreed or strongly agreed with Statement 3. However, 26.8% disagreed or strongly disagreed with this proposal. This suggests dissatisfaction with the status quo but a lack of consensus as to the remedy. One reason for disagreement with this proposal was expressed by a noted member of the Advisory Committee on Student Financial Assistance:

> I think it is very difficult to establish peer schools. Not all two-year schools are peers despite the fact that over

a thousand community colleges are lumped together in most discussions. Further, many proprietary schools are now degree-granting and regionally accredited, and should not be submerged into a peer category of proprietary schools that is made up mostly of short-term occupational certificate-granting programs. Also, is it appropriate to put for-profit schools together with not-for-profit schools as peers?

Several experts expressed the opinion that the CDR ceiling was artificial when it was imposed 10 years ago and is even more artificial today. However, there is something to be said for keeping it, because people in the student aid field understand it. Some penalty ceiling is needed to keep pressure on the schools to improve default aversion practices, particularly at some proprietary schools and Historical Black Colleges and Universities still having problems with high default rates.

Several experts expressed the opinion that the CDR ceiling was artificial when it was imposed 10 years ago and is even more artificial today.

Statement 4: Guaranty agencies and the Department of Education should negotiate a common compensation formula with substantial incentives for curing delinquencies and preventing defaults.

More than 78% strongly agreed or agreed to Statement 4, versus 9.8% who strongly disagreed or disagreed, and 11.8% remained neutral.

Guaranty agencies are currently compensated for 23% of the money they collect from borrowers whose loans are in default (270-days delinquent). If a defaulted loan is converted to a FFELP or FDLP Consolidation loan, the guaranty agency retains 18.5%. These fees of 23% and 18.5% are added as a surcharge to the outstanding student loan balance. This surcharge does not help indebted students get out of debt. According to some guaranty agency officials, this percentage is typically higher than a guaranty agency's actual cost of collecting on defaulted loans. As a result, guaranty agencies have more financial incentive to allow borrowers to default than to prevent the default (GAO, 2002). In 1998, Congress enacted Voluntary Flexible Agreements (VFA) legislation as part of the Higher Education Act amendments, to encourage ED to develop better compensation schemes with the guaranty agencies (GAO, 2002).

One interviewed expert from an education association believes that the guaranty agencies not only have misaligned incentives, they also add to the data integrity problem as a result of all the additional handling of funds and reporting they are required to perform as an intermediary between the lenders, students, schools and the Department of Education.

Statement 5: The federal government, state governments, schools, and lenders should increase funding for outreach programs to educate high-risk student populations. Outreach programs can

help reduce the probability of default by educating students and their parents on the importance of completing their education, their responsibilities as borrowers, and the consequences of defaults.

The survey results for Statement 5 indicate almost universal awareness that changing national and regional demographics are expected to increase the number of high-risk students seeking higher education in the next 10 years and beyond. By the year 2013-2014, the number of Hispanic high school graduates is expected to increase by 80%, Asians 44%, American Indians 16%, and African Americans 6%, while the number of Caucasians graduating from *public* high schools is expected to decline by 11% (WICHE, 2003). Historically, default risk is higher for racial/ethnic minority students and for those in proprietary schools and community colleges. This difference is expected to increase in the next ten years as more students with lower family incomes seek the job skills and upward economic mobility that postsecondary education can offer. Many families in high-risk populations have no experience with higher education; this is the scenario for higher default risk in the years ahead.

Accordingly, 72.6% of the respondents strongly agreed or agreed with the sentiment that the default chances for high-risk populations can be improved through effective outreach education programs, whereas only 11.2% strongly disagreed or disagreed, and 16.3% were neutral. The twelve scholars and experts interviewed were in general agreement that the federal government, state governments, schools, lenders, and private foundations all have roles to play in increasing funding for outreach programs to help increase completion rates and reduce the probability of default. They recommend early and continuous education of students, as well as their parents, on the importance of completing their education, their responsibilities as borrowers, and the serious consequences of default.

On a macro-economic level, former Federal Reserve Chairman Alan Greenspan created a sense of national urgency with respect to this issue in his testimony before the House Financial Services Committee:

> The growing pay gap reflects the "skill premium" commanded by relatively higher educated, better trained workers, and represents a major problem of matching skills of workers to the technological base of the economy, which I believe is an education issue and requires that we address that as quickly and as broadly as we can." Further, he called for "improvements in education and training for school-age children and for adults throughout their working lives" (Greenspan, 2004).

Conclusions

The results of the Likert-scale survey, the in-depth interviews with 12 scholars and experts, and the analysis of extensive archival

data obtained from ED show that the present default measurement metric systems—the CDR calculations—need to be reengineered to provide a more comprehensive assessment of student loan default trends. This study shows that when viewed over eight years, the actual default rate is approximately double the published FY1996 CDR and entire school groups exceed the 25% default rate ceiling. Additionally, over 80% of the survey responses support the development of improved systems that more accurately measure both students and dollars in default.

While there is widespread agreement among survey respondents that the default measures should be changed, they offered only modest support for using peer group ceilings—i.e., four-year colleges, two-year colleges, and proprietary schools—to replace the current single three-year CDR ceiling of 25% for imposing sanctions or loss of Title IV student aid eligibility. Several experts expressed the opinion that the CDR ceiling was artificial when it was imposed 10 years ago and is even more artificial today. However an argument can be made for keeping it: people in the business are familiar with it. Some penalty ceiling is needed to keep pressure on the schools to improve default rates.

The survey results represent a definite mandate about the default aversion productivity of guaranty agencies that are an integral part of the FFEL loan program and funded with federal resources. More than three-quarters of respondents strongly agreed or agreed with the proposition that guaranty agencies and ED should negotiate a common compensation formula with substantial incentives for curing delinquencies and preventing defaults. Only 9.8% strongly disagreed or disagreed while 11.8% remained neutral.

There was near universal agreement among survey participants that the federal and state governments, schools, and lenders should increase funding for outreach programs to educate high-risk populations on the availability of federal student loans, repayment options, and the consequences of defaults.

The results also demonstrate a growing consensus that more resources need to be acquired and applied in innovative ways to promote default aversion strategies to high-risk minority and low-income populations. Nearly 73% of respondents highly agreed or agreed with this proposition. These results reflect the shifting demographics in the United States and its monumental importance to the country's future, as a growing number of new college students will be low-income and from racial and ethnic minority families—groups traditionally at a higher risk for defaulting on student loans. Accordingly, there was near universal agreement among survey participants that the federal and state governments, schools, and lenders should increase funding for outreach programs to educate high-risk populations on the availability of federal student loans, repayment options, and the consequences of defaults. Such policies will improve default aversion and risk management by reducing the probability of defaults occurring.

There was also a general consensus among those interviewed that the government, schools, lenders, and foundations all have a role to play in providing early and continuous

education to students and their parents about the importance of completing education and the serious consequences of default—on the student's quality of life as well as the economic strength of the country. However, who should perform what roles is less clear.

Recommendations

The study results suggest a number of recommendations to improve both the reporting of default rates and the information to students, families, and borrowers about these defaults. Taken together, these recommendations are designed ultimately to reduce the rate of defaults and to lower the costs of the program to the taxpayers.

1. Correct the two-year CDR formula by moving to a tracking period of four years or longer, and tracking dollar balances in default as a second default measure.

Student loans in deferment or forbearance should be removed from both the numerator (defaults) and the denominator (students in repayment) to avoid understatement of the CDR. This endorses the recommendation of the Office of Inspector General (OIG) that the Department of Education should ask Congress to exclude from the default-rate calculations "Borrowers who are not subject to a risk of default during the 2-year cohort period because their loans are in deferment or forbearance status." The Department further advised that these borrowers be included in a later CDR calculation once they are out of deferment or forbearance and are subject to a risk of default (ED-OIG, 2003 p. 2).

2. Undertake intensive default aversion efforts in the first four years of repayment.

Perhaps the most dramatic finding of this research is the behavior of the default curves for the FY1996 cohort. All school types were found to peak in year two and stay high in years three and four. According to several experts interviewed, many student borrowers are not using the deferment and forbearance options to the full extent allowed by statute because they don't know the process. Those students who leave postsecondary education without completing their degree or certificate are most likely to experience difficulty repaying their student loans. This high-risk group needs special attention.

3. Collect data on graduation rates for outcome analysis.

The right data for assessing institutional performance is not being collected. New data should track completion rates and defaults using such variables as full-time and part-time students, stop-outs, transfers, full-time employment, hours worked, delayed enrollment, out-of-state, financial independence, dependents other than spouse, single parents, ethnicity, and first-generation status.

4. Reorganize and re-bid the charters of the guaranty agencies.

The guaranty agencies need an enhanced mission. Guaranty agencies are not needed to supervise debt collection; ED and its debt collection agencies do that job very well. The guaranty agencies know the student populations they serve and should be involved exclusively in borrower education and default aversion.

5. Auction lender rights to make loans in order to attract better loan terms and costs.

The federal cost of funds to lenders participating in the FFEL program could be lowered by the government by introducing competition in interest rate-setting. Eligible lenders with acceptable default aversion statistics would participate in competitive bidding for the right to provide funding on blocks of one to ten billion dollars in loans, at a range of interest rates above yields paid on U.S. Treasury Bonds. The government would select qualified low-cost lenders.

6. Establish a national task force on demographics and default aversion.

With cohort default rates at historic lows, now is a good time to build on past accomplishments before default rates increase. Good ideas need to be synthesized, and action plans proposed. "It is time for a national task force of schools, lenders, guaranty agencies and other stakeholders to develop new proposals and consensus to follow up on the recommendations of the October 2000 Student Loan Repayment Conference" (Kesterman, 2003, p. 48).

The overarching mission of the task force should be to develop a student financial aid policy to assure that enough loans and grants continue to flow from federal, state, and school sources to prevent low- and middle-income students from being squeezed out of the better higher educational opportunities. The concomitant problem is how to assure repayment of the loans when individual borrower debt burdens are increasing and contributing to the overall risk level of the loan portfolio on a national level.

Further, the default question directly relates to how much the federal government should subsidize higher education for the American public. Solutions are needed to serve both national objectives and the needs of individuals to pursue higher education without unmanageable debt burdens.

7. Establish a national panel on critical occupations in need of special student loan debt forgiveness.

Loan forgiveness on the federal level began with the National Defense Education Act of 1958 at a time when America was catching up with the Russians in space. Low-interest loans and

debt cancellations were provided to those entering the teaching field and specializing in mathematics, engineering and science. States have also experimented with debt forgiveness. Arkansas offered medical scholarships as early as 1940. As of 2001-2002, 43 states either provided financial aid or repaid existing loans in exchange for a work commitment also know as "workforce-contingent financial aid" (Kirshstein, Berger, Benetar & Rhodes, 2004).

Increases in aggregate loan limits should be considered to prevent students from losing eligibility before completing their programs.

Many of these programs have experienced implementation problems associated with getting people to keep their commitment to remain on the job. Some loan forgiveness programs have contractual problems that need to be perfected, however the idea is still worth pursuing. We need to determine what incentives are needed to assure that the critical human infrastructures of society are met—such as teachers, nurses, medical doctors, police, firemen, and emergency-response workers—especially in minority communities. Debt forgiveness could become a widespread social engineering tool to channel low- and middle-income students into hard-to-fill skills and low-paying public service jobs that are critical to society (e.g., teachers, nurses, medical doctors, police, firemen, and emergency response workers).

8. Federal loan limits should be increased and loan limits reviewed annually.

Until the recent passage of the Deficit Reduction Act, which increases annual loan limits effective July 1, 2007, annual limits had remained the same for more than ten years despite sharp increases in tuition and college costs. To fill the additional need for credit students have turned to more expensive private loan and credit card markets. The private loan market share increased from $5.6 billion in FY 2002-2003 to $10.6 billion in FY 2003-2004, or 9% of total financial aid (College Board, 2004). Increases in aggregate loan limits should also be considered to prevent students from losing eligibility before completing their programs. The Deficit Reduction Act does not address aggregate student borrowing limits.

9. Evaluate the use of Federal Pell Grants versus loans in terms of impact on program completion.

A number of the scholar and experts interviewed expressed concern about national priorities and the budget deficit curtailing the disbursement of Federal Pell Grants to anyone who qualifies based on economic need. Both grants and loans reduce the risk of non-completion. However, "congressional cost estimates found the cost of grants to be roughly six times the cost of loans, although the actual subsidy depends on future trends in interest rates" (Kane, 1999, p. 16).

It may be possible to stretch the federal government's investment in higher education by replacing Federal Pell Grants

with loans as a line of credit. Grants could still be part of the financial aid program, subject to the student achieving certain completion milestones. For example, students would open a line of credit at the beginning of an academic year. After successfully completing that academic year, the student would receive $4,050 in grant funds to reduce the loan balance. This approach shifts Pell Grant risk from being a 100% taxpayer risk to a risk shared by student borrowers and their schools. Such an approach provides an incentive for students to complete each year, and at the same time, it leverages available Pell Grant budget resources. A drawback to this proposal, however, is that students who do not complete their education may find it difficult to earn sufficient income to repay the line of credit.

10. Provide business tax credits to employers who hire students and new graduates and repay part of their student loans.

Offering tax credits to students and parents for committing to their own future is good social engineering and should be continued as permitted under the Taxpayer Relief Act of 1997 as amended (Kane, 1999). Currently, tax savings to students and families from the deduction on student loans amount to $6.3 billion (College Board, 2004). But many people are too poor to save and therefore are unable to gain enough from tax credits to make the decision to complete their education.

One interviewed expert suggested that leveraging business tax credits might be the next step in expanding the finite budget resources of states, schools, and the federal government available for higher education. Providing tax incentives for employers so they can offer a pretax loan payment as a fringe benefit was also a recommendation of the 2000 Student Loan Repayment Conference (Woods, 2001).

Summary

The federally guaranteed student loan program was created in 1965 as a convenience to middle-class families facing cash-flow problems in meeting college costs. "From these simple beginnings arose a program that is now the centerpiece, not only of student aid, but of the financing of the entire enterprise of higher education itself" (Breneman, D., as cited in Fossey & Bateman, 1998). Student loan repayment has evolved into a national social issue resulting from the necessity of increased borrowing to pay for higher education. Millions of Americans are now carrying very large student loan debt burdens (Baum & O'Malley, 2003), which contribute to the overall risk level of the student loan portfolio on a national level. This problem also contains an associated risk of individual student borrowers becoming bankrupt or seriously burdened with debt that affects their quality of life. Ultimately, the fundamental question directly relates to how much the federal government is willing to subsidize higher education for the American public and for the future of our country.

This study supports the need for more comprehensive metric systems to analyze and predict trends in student loan defaults. Better metrics are needed, now more than ever, for management of borrower risks associated with higher college costs, heavy reliance on student loans, and higher borrower debt burdens. Higher student loan debts are made more acute by virtue of changing demographics due to increasing minority and first generation student populations with generally lower family incomes. All alarms are flashing red about this high-risk scenario. Ensuring student loan repayment is every bit as important today as it was when the Student Loan Repayment Symposium was held in October 2000. This study builds on the recommendations of that symposium (Woods, 2001), which was a watershed event that in many ways remains unfulfilled.

References

Advisory Committee on Student Financial Assistance. (2001). *Access denied: Restoring the nation's commitment to equal educational opportuni*ty. Washington DC:. Author.

Bateman, M. & Fossey, R. (1998). *Condemning students to debt.* New York: Teachers College Press.

Baum, S. & O'Malley, M. (2003). *College on credit: How borrowers perceive their educational debt. Results of 2002 National Student Loan Survey.* Boston: Nellie Mae Corporation.

Breneman, D. (1998). In R. Fossey & M Bateman (Eds.), *Condemning students to debt* (p.ix). New York: Teachers College, Columbia University.

Budget of the United States Government, Fiscal Year 2004. Appendix, p. 347. Washington DC: U.S. Government Printing Office.

College Board, The (2004). *Trends in student aid 2004.* New York: College Board.

Creswell, J. (2002). *Educational research: Planning, conducting, and evaluating quantitative and qualitative research.* Upper Saddle River, NJ: Merrill Prentiss Hall.

Davis, J.S. (2004). Personal e-mail message dated December 10, 2004.

Greenspan, A. (2004, July 22). Greenspan says workers' lack of skills lowers wages. *Washington Post*, p.1.

Hoover, E. (2004, October 20). Public-college tuition rises again, but less than it did last year. *The Chronicle of Higher Education*, p.1.

Kane, T. (1999). *The price of admission: Rethinking how Americans pay for college.* Washington, D.C.: The Brookings Institute/ Russell Sage Foundation.

Kesterman, F. (2003). The federal student loan programs need better metrics and default aversion strategies. *Journal of Student Financial Aid, 33*(2).

King, T. & Bannon, E. (2002). The burden of borrowing: A report on the rising rates of student loan debt. Washington DC: The State PIRGs' Higher Education Project.

Kirshstein, R.J., Berger, A.R., Benetar, E. & Rhodes, D. (2004, February). Workforce contingent financial aid: How states link financial aid to employment. Indianapolis, IN: Lumina Foundation for Education.

National Center for Public Policy and Higher Education (NCPPE) (2002). Losing ground: A national status report on the affordability of American higher education. San Jose, CA: NCPPHE.

National Postsecondary Student Aid Study (NPSAS 2000) Office of Postsecondary Education. (OPE, 2001). 1997-2000 federal student loan programs data book. Retrieved May 5, 2003, from http://www.ed.gov/offices/OPE/data.

National Student Loan Data System (NSLDS) (2003). National Student Loan Data System data provided under FOIA Request FSA 2003-5319F, e-mail Parrish.to Kesterman, dated July 17, 2003, and subsequent data queries thru November 6, 2003.

UCLA, (2004). *What does Cronbach's alpha mean?* UCLA Academic Technology Services. Retrieved December 5, 2004 from http://www.ats.ucla.edu/stat/spss/faq/alpha.html.

U.S. Department of Education, Office of Inspector General (2003, December). *Audit to determine if cohort default rates provide sufficient information on defaults in the title IV loam programs* (ED-OIG/A03-C0017). Philadelphia, PA: Author.

U.S. General Accounting Office (January, 2002*). Flexible agreements with guaranty agencies warrant careful evaluation* (GAO-02-254). Washington, DC: U.S. Government Printing Office.

Western Interstate Commission for Higher Education (WICHE), (2003, December). *Knocking at the college door: Projections of high school graduates by state, income and race/ethnicity, 1988 to 2018.* Boulder, CO: WICHE.

Woods, G. (2001). *Ensuring student loan repayment: A national handbook of best practices.* In Student Loan Repayment Symposium, October 2-4, 2000. Washington, DC: U.S. Department of Education.

APPENDIX
Likert-Scale Survey Results

Survey Statements	Frequency	Percent
Statement 1		
Highly disagree	7	4.6
Disagree	13	8.5
Neutral	8	5.2
Agree	68	44.4
Highly agree	57	37.3
Mean = 4.01		
SD = 1.088		
Statement 2		
Highly disagree	2	1.3
Disagree	15	9.8
Neutral	13	8.5
Agree	65	42.5
Highly agree	58	37.9
Mean = 4.06		
SD = 0.988		
Statement 3		
Highly disagree	11	7.2
Disagree	30	19.6
Neutral	18	11.8
Agree	61	39.9
Highly agree	33	21.6
Mean = 3.49		
SD = 1.231		
Statement 4		
Highly disagree	4	2.6
Disagree	11	7.2
Neutral	18	11.8
Agree	54	35.5
Highly agree	66	43.1
Mean = 4.09		
SD = 1.035		
Statement 5		
Highly disagree	1	0.7
Disagree	16	10.5
Neutral	25	16.3
Agree	52	34.0
Highly agree	59	38.6
Mean = 3.99		
SD = 1.016		