

## A Proposal to Improve Institutional Accountability and Reward Colleges Using a Student Default Risk Indicator (SDRI)

April 24, 2015

The federal government should tie colleges' eligibility for federal aid more closely to the level of risk those institutions present to students and taxpayers, and provide rewards for colleges where risks are low. To achieve this, we recommend using a new measure called the Student Default Risk Indicator (SDRI).

**WHY THE SDRI?** Currently, the federal government uses cohort default rates (CDRs) to assess college eligibility for federal student aid funding from the U.S. Department of Education (Title IV funding). Colleges with CDRs above certain thresholds may face sanctions that end their eligibility for federal aid. However, the meaning and utility of CDRs are limited because they exclude any student who does not borrow. For instance, if only two out of 100 students at a college borrow, the fact that one of them defaults may not reflect problems with the education received by the other 99 students.

The Student Default Risk Indicator (SDRI) corrects for this by multiplying each school's CDR by the share of students at that school who borrow. By incorporating the share of students who borrow the SDRI more accurately conveys a student's risk of default at a given school.

**COMPARISON OF SDRI AND CDR:** Consider two schools with identical CDRs of 20% (see below). At the first school, 90% of students borrow, so roughly 18 out of every 100 enrolled students end up in default shortly after entering repayment. At the second school, only 5% of students borrow, so only one out of 100 students ends up in default within the same time period. The schools' CDRs are the same, but the risk each school poses, to students and more generally to taxpayers, is quite different.

	CDR	Borrowing Rate	Students' Risk of Default	SDRI
<b>College 1</b>	20%	90%	18%	18%
<b>College 2</b>	20%	5%	1%	1%

**PROPOSAL:** Because it is inclusive of all students, the SDRI is a more accurate measure of risk than the CDR and could be used to both reward some colleges and require others to share in students' and taxpayers' risk. The proposal below would begin rewarding colleges immediately based on their SDRIs, and introduce risk-sharing and SDRI-based eligibility determinations in 2019 to provide schools time to prepare. The estimates below are based on the 4,516 colleges for which SDRIs can be calculated.

### *Beginning in 2016:*

- **Rewards:**
  - Schools with SDRIs at or below 2% would receive additional funding based on their low-income student enrollment. Currently, 18% of colleges have an SDRI of 2% or lower (enrolling 27% of all students).
  - Schools with SDRIs at or below 5% would receive additional flexibility to help foster innovation. Currently, 45% of schools have an SDRI of 5% or lower (enrolling 62% of all students).
- **Risk reduction plans:** Schools with an SDRI of 10% or greater would be required to adopt a risk reduction plan to lower their SDRI. Currently schools are not required to adopt a plan until their CDR reaches 30%.

### *Beginning in 2019:*

- **Risk-sharing:** Schools with SDRIs between 10% and 20% would be required to share in the risk. The level of risk-sharing increases as the risk to students and taxpayers increases, as measured by the school's SDRI and the extent of the school's reliance on federal aid. Currently, 21% of schools have an SDRI at or above 10% and below 20% (enrolling 13% of students); these schools have a median SDRI of 13.5%.
- **Ineligibility:** Schools with SDRIs at or above 20% would not be eligible for federal funding. Currently, 5% schools have an SDRI of 20% or higher (enrolling 1% of students).

For more about our proposal, see [our full comments in response to the Senate HELP Committee's request for feedback on college risk sharing](#).