A NEW APPROACH TO COLLEGE RISK SHARING

ENHANCING ACCOUNTABILITY TO IMPROVE STUDENT OUTCOMES

MARCH 2017

INTRODUCTION

The federal government holds students who receive federal student aid accountable for studying and making progress toward a credential – rescinding their aid eligibility when they fail to meet established standards, and imposing costly consequences on each student who defaults. But there are currently few consequences for schools that fail to graduate large shares of students or that consistently leave students with debt they cannot repay. As a result, *there is growing bipartisan interest in giving colleges a clear stake in their students' success and ability to repay their student loans*.

In 2015, Senate Health, Education, Labor, & Pensions (HELP) Committee Chairman Alexander issued a white paper[1] on the concept of college risk sharing ('skin in the game') and held a hearing on the issue,[2] and two college risk sharing bills focusing on student debt outcomes were introduced in the Senate.[3]

In 2016, a number of higher education researchers and organizations, including TICAS, put forth detailed risk sharing proposals.[4] While the proposals vary, they all acknowledge the shortcomings of our current all-or-nothing approach to college regulation and oversight that provides few incentives for colleges to improve or for colleges that serve students well to enroll more low-income students.

To successfully promote college access, success, and affordability for *all* students, college risk sharing proposals need to take explicit steps to avoid potential unintended consequences for students and colleges. For example, proposals should be designed to:

- *Promote college access for low-income students* and address concerns that risk sharing might push colleges to improve student outcomes by altering admissions criteria and enrolling fewer low-income students.
- *Support Historically Black Colleges and Universities (HBCUs)* to avoid exacerbating pre-existing, historic inequities and avoid harming these under-resourced colleges.
- *Protect access to federal student loans*, which are the safest way to borrow for school.
- *Complement more targeted accountability measures already in place*, including the "gainful employment" requirement for career education programs and the 90-10 rule for for-profit colleges.

This brief outlines a proposal that addresses each of these issues using existing, publicly available data. The proposal includes: a robust, reliable, and student-centered debt outcome metric for measuring college risk; clear, fixed performance thresholds for colleges to meet; substantial rewards to protect and incentivize low-income access; proportional, graduated sanctions to encourage improvement; early intervention before a college is anywhere near losing eligibility; and carefully phased implementation so colleges have sufficient time to adjust and improve before facing penalties.

Our intent is to highlight both the challenges in designing a college risk sharing system as well as solutions for addressing them. For additional technical details not contained in this brief, including additional modeled outcomes and more detailed calculations of rewards and sanctions, please see our December 2016 working paper, *A New Approach to College Accountability: Balancing Sanctions and Rewards to Improve Student Outcomes.*[5]

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OUR PROPOSAL: A SYSTEM OF REWARDS AND SANCTIONS TO IMPROVE STUDENT OUTCOMES

Our proposed accountability system is designed to reward colleges doing well and encourage them to enroll more low-income students, and to ensure that all colleges have incentives to improve – not to punish colleges or take resources away from schools that are serving students well. Based on current data, a majority of schools would receive either financial or non-financial rewards under our proposed system, and less than 20% would be subject to risk sharing payments if they did not improve during the implementation period.

The system would apply to all types of colleges, and provide a range of outcomes, including rewards and graduated sanctions based on a measurement of risk that a college poses to students and taxpayers. We propose measuring risk using one of two possible straightforward, student-based debt outcome measures: the Student Default Risk Indicator (SDRI) or the Student Non-repayment Risk Indicator (SNRI). Each measure has its strengths and weaknesses, but each can be used to design an accountability system where similar shares of schools face each possible outcome.

Outcomes for colleges under our proposal include:

- **Financial and non-financial rewards** for high-performing schools to encourage schools that serve low-income students well to enroll more low-income students and innovate to further improve outcomes.
- **Risk-reduction plans** for at-risk schools. Similar to today's default-reduction plans, but required at a much earlier point so that colleges improve before facing sanctions.
- **Financial sanctions ("risk sharing payments")** for at-risk schools, which increase as a college's risk to students and taxpayers increases in order to establish meaningful consequences that incentivize improvement.
- **Title IV eligibility loss** for schools posing unacceptable levels of risk.

We recommend phased implementation over several years, immediately providing rewards for high-performing schools and requiring risk-reduction plans for lower-performing institutions, while delaying implementation of risk sharing payments to give schools sufficient time to lower their risk before being subject to sanction.

In addition to motivating improved student outcomes across the board, our proposal also includes an incentive for schools to participate in the federal loan program because offering federal loans would be a requirement for rewards.[6]

In light of the unique circumstances of the establishment and historic underfunding of Historically Black Colleges and Universities (HBCUs), we propose significant additional resources for HBCUs to improve student outcomes in order to avoid unintentionally deepening federally recognized historic, structural inequities with the new accountability structure.[7] We propose new temporary mandatory funding of $100 million per year for eight years, beginning in the first year of implementation of the new accountability system, to provide substantial new funding to HBCUs for the three years before any college is required to make risk sharing payments, and for five years afterward.

It is important to note that our proposal is designed to replace the current Cohort Default Rate (CDR)-based system of federal aid eligibility but leave in place other federal college accountability measures, such as the "gainful employment" requirement for career education programs, and the 90-10 rule for for-profit colleges.[8]

The importance of a transparent, student-based measurement of risk

The CDR is a well established and important measure, but the way it is currently used to determine college eligibility for federal aid suffers from significant shortcomings in the context of risk sharing. First, the CDR cutoff for eligibility is a blunt, all-or-nothing threshold such that a school with a CDR of 29.9% remains fully eligible for aid while a school with a CDR of 30% may lose eligibility. Second, the metric only considers the risk to students who take out loans because it does not account for the share of students at a school who borrow. To more accurately measure the risk a college poses to a typical student, we recommend measuring risk using one of two possible student-based debt outcome metrics that include all students and account for the share of students who borrow: the Student Default Risk Indicator (SDRI) or the Student Non-Repayment Risk Indicator (SNRI).

Multiplying a school's CDR by the share of students at that school who borrow more accurately conveys a student's risk of default. While student loan default is always a catastrophic outcome for any individual student, using a metric that accounts for the share of students who borrow at a college helps to better identify schools where bad outcomes for students are more systemic and worthy of intervention via financial sanction. Similarly, multiplying a school's non-repayment rate (the inverse of the repayment rate) by the share of students who borrow more accurately coveys a student's risk of being left with debt they cannot repay.

Understanding the SDRI and SNRI

Consider two schools with identical CDRs of 20%. At School A, 90% of students borrow, resulting in an SDRI of 18% because 18% of all students end up in default within three years of entering repayment. At School B, only 5% of students borrow, resulting in a SDRI of 1% because only 1% of all students end 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. In one simple calculation, the SDRI measures the risk to both students and taxpayers, conveying the risk of defaulting for a typical student at the school. This calculation of the SDRI is illustrated below.

CALCULATION OF THE STUDENT DEFAULT RISK INDICATOR (SDRI)

	Cohort Default Rate		Borrowing Rate		Student Risk of Default (SDRI)
School A	20%	x	90%	=	18%
School B	20%	x	5%	=	1%

Similarly, the actual risk posed by two schools with identical non-repayment rates can be most accurately conveyed by multiplying the non-repayment rate by the share of students who borrow, as illustrated below.

CALCULATION OF THE STUDENT NON-REPAYMENT RISK INDICATOR (SNRI)

	Non-Repayment Rate		Borrowing Rate		Student Risk of Non-Repayment (SNRI)
School A	60%	x	90%	=	54%
School B	60%	x	5%	=	3%

While we recommend policymakers adopt only one risk metric to determine college sanctions and rewards, we outline our proposal under both the SDRI and the SNRI to demonstrate the viability of each. There are important considerations relating to the use of either the SDRI or the SNRI, and for a discussion of these potential tradeoffs, see page 6 of our December 2016 working paper.[9] Whether using the SDRI, the SNRI, or another metric, it is important that colleges have the opportunity to review and challenge the underlying data as they can currently for CDRs and Gainful Employment rates.[10]

The importance of clear, fixed performance thresholds

To enable colleges to clearly know the standards to which they are being held, and to ensure that our system motivates rather than punishes schools, we propose setting clear, fixed thresholds at points where the risk to students and taxpayers is exceptionally low or unacceptably high. Setting performance thresholds based on relative performance (for example, where the lowest 25% of schools always make risk sharing payments) means that schools will always be sanctioned even if all schools are performing at a relatively high level. Relative thresholds furthermore make it very difficult for schools to know in advance what targets they must meet in order to avoid sanction, or to receive a reward. Instead, we recommend fixed performance standards with the understanding that these standards may require periodic reevaluation[11]

We have set clear, fixed thresholds at points where we believe a reasonable person should agree that the risk to students and taxpayers is unacceptably high. We want schools that fall into the risk sharing range to see the value in lowering students' risk, and, most importantly, to be able to successfully do so through changed behavior.

If using the SDRI to measure risk, the thresholds we recommend in the table below mean that financial rewards would go to schools where no more than 2% of all students default on their loans, and that schools would lose Title IV eligibility when at least 20% of their entire student body, not just borrowers, defaults on their loans. If using the SNRI, the thresholds we recommend mean that financial rewards would go to schools where no more than 15% of students have made no progress in paying down their loans after three years in repayment, and schools would lose Title IV eligibility when 70% or more of their students have made no progress paying down their loans after three years.

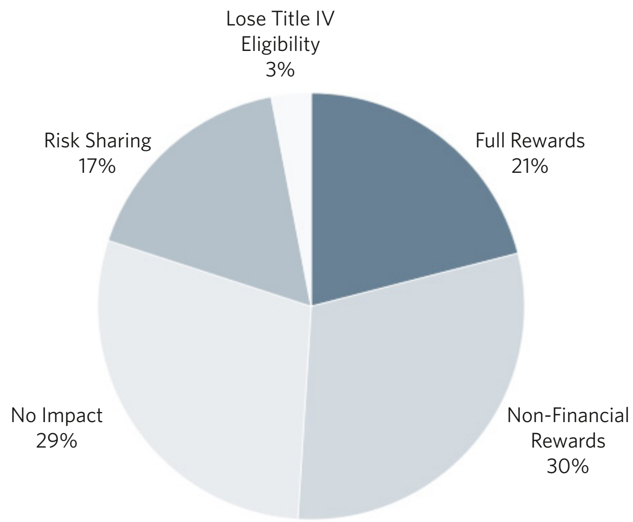
PROPOSED THRESHOLDS USING SDRI AND SNRI

OUTCOME	SDRI THRESHOLD	SNRI THRESHOLD
Full rewards	<=2%	<=15%
Non-Financial Rewards	>2% and <=5%	>15% and <=30%
No Impact	>5% and <10%	>30% and <45%
Risk Sharing Payment & Risk-Reduction Plan	>=10% and <20%	>=45% and <70%
Title IV Eligibility Loss	>=20%	>=70%

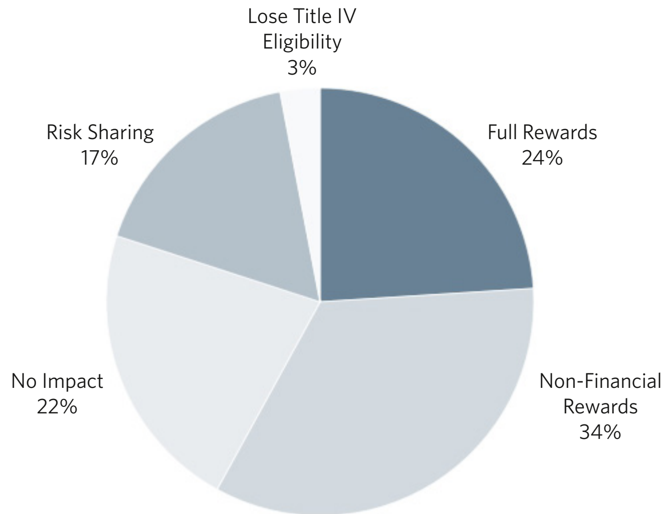
As discussed above and detailed further below, we propose immediate adoption of rewards and delayed implementation of sanctions so that schools will have time to improve before they are subject to risk sharing payments or eligibility loss under a new metric. Using currently available data, which overstate the level of risk posed to colleges because they have not yet had the opportunity to improve, our proposal would result in the following outcomes for colleges using either the SDRI or SNRI:

- More than half of all schools, enrolling at least two-thirds of undergraduates, receive financial or non-financial rewards under our proposal;
- About one-fifth of schools, enrolling 10% of undergraduates, make risk sharing payments; and
- Three percent of schools, enrolling 1% of undergraduates or less, lose eligibility.

COLLEGE OUTCOMES USING SDRI[12]
(Percent of Schools)



COLLEGE OUTCOMES USING SNRI[13]
(Percent of Schools)



A majority of the colleges in each control type (public, non-profit, for-profit) is either rewarded or not impacted by our proposal using either SDRI or SNRI. For example, although the for-profit sector has the highest average SDRIs and SNRIs, a majority of these colleges would either be rewarded or not impacted under our proposal even if no improvement occurred during the implementation period.

The importance of rewarding colleges that serve low-income students well

One of the key concerns associated with college risk sharing is that it might unintentionally encourage colleges to become more selective in which students they admit, resulting in less access for low-income students. While many colleges, particularly open-access public colleges, may not have the ability to limit enrollments in this way, any college risk sharing proposal must be designed to protect against the potential risk of decreasing access to college for low-income students. Our proposal addresses this concern by providing significant financial rewards to colleges that serve low-income students well, and base the size of the reward on the college's low-income enrollment. Rewards and sanctions work together to create an effective accountability structure that incorporates both carrots and sticks to avoid unintended consequences for vulnerable students.[14]

Our reward structure is a crucial component of our accountability system, and is designed to not only protect low-income student access but also provide an effective incentive for high-performing schools to enroll more low-income students.

Under our proposal, all high-performing schools (SDRI <=5% or SNRI <=30%) receive non-financial rewards, while highest performing schools (SDRI <=2% or SNRI <=15%) receive financial rewards equivalent to about $775 for each Pell Grant recipient enrolled.[15] By calculating the size of the financial reward based on low-income student enrollment, the largest financial rewards are highly targeted to colleges serving many students with the highest financial need. Using either the SDRI or SNRI, public schools (where 68% of all students receiving Pell Grants are enrolled) receive more than 80% of the financial rewards, and a majority of Pell Grant recipients attend schools that would be rewarded.

Our reward structure is a crucial component of our accountability system, and is designed to not only protect low-income student access but also provide an effective incentive for high-performing schools to enroll *more* low-income students.

The importance of early intervention and graduated risk sharing payments

Unlike today's all-or-nothing CDR threshold, a system of graduated financial sanctions based on risk is designed to encourage colleges to improve student outcomes long before a school is at risk of losing Title IV eligibility. We specifically propose that schools that are below our recommended eligibility cutoff threshold but still fall into a relatively high-risk SDRI or SNRI range (SDRI >=10% and <20%, or SNRI >= 45% and <70%) be required to make a risk sharing payment, and develop a plan to improve performance.

Today, schools are not required to develop a plan to reduce their default rate until 30% of borrowers are defaulting. However, at that point, schools have less than two years to reduce their default rate to avoid losing eligibility for federal student aid. We propose requiring schools to develop a risk-reduction plan much earlier. This will help schools lower or entirely avoid risk sharing payments and steer clear of losing aid eligibility, when they are well below the eligibility loss threshold (i.e., when the risk of default is at least 10% or the risk of non-repayment is at least 45%).

For schools subject to financial sanctions, we propose graduated risk sharing payments, which could be calculated as 5%-14% of a school's defaulted loan volume depending on performance.[16] For example, a school where students have a 10% chance of defaulting (if the SDRI were used), or a 45% chance of not repaying their loans (if the SNRI were used), would have to make a risk sharing payment equal to 5% of the balance of the loans on which the most recent cohort of students defaulted. The same assessment rate will lead to larger or smaller payments depending on the size of each college's defaulted loan volume, and higher risk schools will pay a higher share of their defaulted loan volume.

It is important to note that the size of the payment that would be effective at motivating college behavior, without being so burdensome that it would cause irreparable damage, is unknown and should be carefully considered prior to adoption of a risk sharing system.

The current data show that most colleges subject to risk sharing penalties under our proposal (using either the SDRI or SNRI) are close to the lower bound of the risk sharing ranges we recommend. This means most of these colleges should be able to reduce their risk during the implementation period and avoid having to make any risk sharing payments.

PROPOSED RISK SHARING PAYMENT RATES		
SDRI RANGE	SNRI RANGE	SHARE OF DEFAULTED VOLUME
>=10% and <11%	>=45% and <47.5%	5%
>=11% and <12%	>= 47.5% and <50%	6%
>=12% and <13%	>=50% and <52.5%	7%
>=13% and <14%	>=52.5% and <55%	8%
>=14% and <15%	>=55% and <57.5%	9%
>=15% and <16%	>=57.5% and <60%	10%
>=16% and <17%	>=60% and <62.5%	11%
>=17% and <18%	>=62.5% and <65%	12%
>=18% and <19%	>= 65% and <67.5%	13%
>=19% and <20%	>=67.5% and <70%	14%

The importance of phased implementation

Any new accountability system for colleges should be phased in over a long enough period of time that schools are given a meaningful opportunity to adjust and improve before facing potential sanctions. Our recommended phased implementation, detailed in the table below, calls for high-performing schools to have immediate access to rewards because we believe it will encourage high-performing colleges to enroll more low-income students and continue to offer federal loans, and that it will encourage other schools to immediately take steps to improve so they might earn rewards. We also recommend requiring risk-reduction plans immediately for schools with risk levels that, if unchanged, would result in risk sharing payments or eligibility loss once the system is fully implemented.

<table>
<tr><th colspan="5">PROPOSED IMPLEMENTATION SCHEDULE</th></tr>
<tr><th>YEAR OF IMPLEMENTATION</th><th>REWARDS</th><th>RISK SHARING PAYMENT</th><th>RISK-REDUCTION PLAN</th><th>ELIGIBILITY LOSS</th></tr>
<tr><td>Current policy</td><td>None</td><td>None</td><td>Required when school's CDR is at sanction level for one year</td><td>Occurs at CDR>=30% for three years or over 40% in one year</td></tr>
<tr><td>Year 1</td><td rowspan="4">Yes</td><td rowspan="3">No change from current policy</td><td rowspan="4">Required before schools reach sanction level</td><td rowspan="3">No change from current policy</td></tr>
<tr><td>Year 2</td></tr>
<tr><td>Year 3</td></tr>
<tr><td>Year 4 & beyond</td><td>Yes</td><td>Occurs at SDRI>=20% or SNRI >=70%</td></tr>
</table>

CONCLUSION

There is growing bipartisan agreement that colleges need to have a greater stake in their students' success and ability to repay their debts. To better align colleges' incentives with those of students and taxpayers, the new federal college accountability system outlined in this brief includes scaled risk sharing payments to create "skin in the game" for high-risk colleges, provides financial and nonfinancial rewards to encourage all schools to improve and enable schools serving their students well to enroll more low-income students, and avoids unintended consequences for both colleges and students. We look forward to the continuing broad and bipartisan dialogue on college risk sharing, and exploring additional ideas on how best to structure a new approach to federal accountability for colleges.

We thank the Bill & Melinda Gates Foundation and Lumina Foundation for their support of this brief and related work on risk sharing. The views expressed in this report are those of The Institute for College Access & Success (TICAS) and do not necessarily reflect the views of our funders.

ENDNOTES

[1] Senate Committee on Health, Education, Labor & Pensions. 2015. *Risk-Sharing/Skin-in-the-Game Concepts and Proposals*. Available at http://www.help.senate.gov/imo/media/Risk_Sharing.pdf.

[2] Reauthorizing the Higher Education Act: Exploring Institutional Risk-sharing. May 20, 2015. http://www.help.senate.gov/hearings/reauthorizing-the-higher-education-act-exploring-institutional-risk-sharing.

[3] See Senator Shaheen. Press Release. August 5, 2015. Senators Shaheen, Hatch, Introduce Bipartisan Bill to Improve Quality of College Education. http://bit.ly/2mj5w1k; and Senator Reed. Press Release. May 1, 2015. Reed Leading Effort to Protect Student Borrowers. http://bit.ly/2miW4en.

[4] See "Other papers on risk sharing in higher education" in Miller, B. and Libassi, C.. 2016. *Sharing the Risk: A Plan for Colleges to Participate in the Costs of Student Loan Failure*. http://ampr.gs/2ozYIC8.

[5] TICAS. 2016. *A New Approach to College Accountability: Balancing Sanctions and Rewards to Improve Outcomes*. Available at http://ticas.org/sites/default/files/pub_files/ticas_risk_sharing_working_paper.pdf.

[6] Our research has found that nearly one million community college students do not have access to federal loans, the safest way to borrow to pay for school. TICAS. 2016. *States of Denial: Where Community College Students Lack Access to Federal Student Loans*. http://ticas.org/sites/default/files/pub_files/states_of_denial.pdf.

[7] See Title III Part B, Strengthening Historically Black Colleges and Universities Program. http://www2.ed.gov/programs/iduestitle3b/funding.html.

[8] For Information and background in career education accountability, see http://www.protectstudentsandtaxpayers.org/more-about-the-issues/.

[9] Available at http://ticas.org/sites/default/files/pub_files/ticas_risk_sharing_working_paper.pdf.

[10] To model outcomes under our proposal, we use institutional repayment rates from the College Scorecard, which is currently the only public source for repayment rate data for all schools. However, the repayment rates available in the College Scorecard are not currently used for accountability, and are not subject to institutional review. Repayment rates in the College Scorecard measure the share of undergraduate Stafford loan borrowers who entered repayment in FY 2011 or FY 2012, were not in default at the time of measurement, and had reduced their principal balance by at least $1 three years into repayment. See the College Scorecard data documentation for more information on the calculation. Repayment rates can also be calculated differently, as they are, for example, under the gainful employment and borrower defense rules. We recommend careful analysis of the implications of different repayment rate calculations prior to implementation of an SNRI metric.

[11] The thresholds we propose are based on current available data. There are foreseeable circumstances under which thresholds should be reconsidered. For example, successfully adopting policies that automatically move severely delinquent borrowers into income-driven repayment plans may lower default rates and SDRIs without colleges increasing student achievement or affordability.

Additionally, SNRI thresholds are based on the College Scorecard calculation of repayment rate. Other thresholds may be appropriate if a different repayment rate calculation is used (for example, one that calculates the share of principle balance repaid and allows for negative repayment rates as is done by Chou et al., 2017. Measuring Loan Outcomes at Postsecondary Institutions: Cohort Repayment Rates as an Indicator of Student Success and Institutional Accountability. NBER Working Paper No. 23118. Available at http://www.nber.org/papers/w23118.pdf).

[12] Using US Department of Education Data, SDRI is calculated only for schools that have borrowers in repayment for FY 2012, Stafford loan disbursements for 2012-13, and borrowing rates reported for 2012-13. An SDRI can be calculated for 4,424 schools.

[13] Using US Department of Education Data, SNRI is calculated only for schools that have borrowers in repayment for FY 2012, Stafford loan disbursements for 2012-13, undergraduate borrowing rates reported for 2012-13, and three-year repayment rates reported for the FY11-12 pooled cohort. An SNRI can be calculated for 4,188 schools.

[14] The funding for the proposed rewards should not come from the risk sharing payments collected from high-risk schools because rewards aimed at increasing innovation and low-income enrollment at high performing schools should not be contingent on other schools serving students poorly. Furthermore, if our proposed system works as intended, risk sharing payments should be small and decline over time as schools improve, whereas rewards will need continuous funding.

[15] Rewards would be assessed based on the amount of Pell Grant funds disbursed to all students divided by the maximum Pell grant award level. Under these estimates, colleges would receive $775 in rewards for each $5,500 (the maximum Pell amount in 2012-13) disbursed. To avoid rewarding schools with low borrowing rates but with default rates that exceed current Title IV eligibility thresholds, schools with CDRs of 30% or higher would not be eligible for rewards.

[16] There are other reasonable ways to calculate risk sharing payments. However, using defaulted loan balance of the most recent three year CDR cohort as the base for risk sharing payments helps ensure that preventing student loan default remains a key focus for colleges, especially if the SNRI, which focuses on a more broad range of negative repayment outcomes, is used to measure risk. A minimum payment amount, such as $5,000, could also be established to ensure at least nominal penalty amounts.

the institute for college access & success

405 14th Street, Suite 1100
Oakland, CA 94612
510.318.7900

110 Maryland Avenue, N.E., Suite 112
Washington, DC 20002
202.223.6060

info@ticas.org
www.ticas.org