

April 24, 2015

The Honorable Lamar Alexander  
Chairman  
Senate Health, Education, Labor, and Pensions Committee  
United States Senate  
Washington, D.C. 20510

Dear Chairman Alexander:

Thank you for the opportunity to provide feedback on your thoughtful staff [white paper](#) on college risk-sharing concepts and proposals. We strongly agree with you that a one-size-fits-all approach is neither appropriate nor currently working, and that colleges should have a clearer stake in their students' success, debt, and ability to repay it. Currently, students are held accountable for studying and making progress toward a credential, but there are few consequences for schools that fail to graduate large shares of students or consistently leave students with debts they cannot repay. We also appreciate your attention to the importance of providing incentives to colleges to invest more in academic and other support services to improve completion and reduce default, so that both colleges and students ultimately benefit from better outcomes.

We have developed a college risk sharing proposal to achieve these goals. Specifically, we recommend using a Student Default Risk Indicator (SDRI)—a school's cohort default rate (CDR) multiplied by its borrowing rate—to require risk sharing by colleges based on the risk they pose to students and taxpayers, reward schools for serving low-income students well, and end federal aid eligibility for schools that pose unacceptable risks. The proposal has the following advantages:

- can be implemented using currently available data;
- applies to all types of colleges;
- aligns the college's incentives with those of students and taxpayers;
- provides schools with incentives to improve because eligibility would no longer be all-or-nothing;
- promotes innovation among schools that serve students well by giving them greater flexibility to innovate; and
- encourages schools that serve students well to enroll more low-income students by distributing financial rewards to them based on the number of Pell Grant recipients they enroll.

Attached is a one-page summary of the proposal followed by greater detail and responses to the questions raised in the white paper. We welcome feedback on our proposal. If your staff has any questions, Jessica Thompson at [jthompson@ticas.org](mailto:jthompson@ticas.org) would be glad to answer them. Thank you again for this opportunity to comment and for your leadership on this issue. We look forward to working with you on this and other issues in reauthorizing the Higher Education Act.

Sincerely,



Lauren Asher, President

## 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 SDRI, 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 SDRI can be calculated.

*Beginning in 2016:*

- **Rewards:**
  - Schools with SDRI 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 SDRI 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 SDRI 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 SDRI 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).

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

We have developed a detailed college risk sharing proposal that replaces the current all-or-nothing federal aid eligibility system with one that more closely ties a college's eligibility for federal funding to the risk students take by enrolling and the risk taxpayers take by subsidizing it. The proposal also provides financial and non-financial rewards to schools that serve students well. Specifically, we recommend using a Student Default Risk Indicator (SDRI) – a school's cohort default rate (CDR) multiplied by the school's borrowing rate – to:

- **Offer Rewards.** Schools with low SDRI would be eligible for financial and non-financial rewards, providing incentives for colleges with low SDRI to innovate and enroll more low-income students.
- **Implement Risk Sharing.** Schools with SDRI approaching the cutoff would be required to pay a fee. The level of risk-sharing would increase as the risk to students and taxpayers increases, as measured by the school's SDRI and by the extent of the school's reliance on federal aid. The risk-sharing fees would be used to fund financial aid and counseling.
- **End Eligibility for Schools with Unacceptable Performance.** Schools with an unacceptably high SDRI would lose eligibility for federal aid. This SDRI threshold would replace current CDR thresholds.

### Which Types of Colleges Would Be Subject to Risk Sharing? All Colleges

**All colleges with an SDRI between 10% and 20% would be subject to risk sharing.** For all colleges, the risk sharing rate would increase as the school's SDRI approaches 20%. For schools that receive a *majority* of their funding from federal student aid, the risk sharing rate would be applied to their *total federal* student aid revenues. For schools that receive *less than half* of their funding from federal student aid, the fee would be applied to their *federal Stafford loan volume only*. Federal taxpayers have a greater stake in and leverage over schools receiving a majority of their funding from federal student aid, which is why we propose that such schools be required to do more risk-sharing.

### What Would Be Used to Measure Risk? The Student Default Risk Indicator (SDRI)

We recommend using the **Student Default Risk Indicator (SDRI)** to determine risk sharing. The SDRI is the existing three-year CDR multiplied by a college's student loan borrowing rate. The student loan borrowing rate is equal to the total number of all students taking out federal Stafford loans or private education loans divided by the total number of all students.<sup>1</sup>

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<sup>1</sup> We recommend that all any legislation use the combined undergraduate and graduate borrowing rate. SDRI estimates and calculations in these comments are based on only *undergraduate* borrowing rates because those are all that the Department of Education makes public. However, the Department has data in NSLDS to calculate borrowing rates based on *all students* who take out federal Stafford loans (i.e., the same borrowers whose defaults are measured in CDRs). Because graduate students who receive PLUS loans should also have received Stafford

In one simple calculation, the SDRI measures the risk to both students and taxpayers. There are significant advantages to using the SDRI as we have proposed. It prevents any cliff effects where a 0.1% increase in loan participation or \$1 increase in loan volume would suddenly trigger significant risk sharing. It also avoids the need to increase the loan volume trigger over time (or have more and more colleges affected by inflation). It applies equally across all colleges without discouraging schools from offering federal student loans, whereas relying on CDRs alone would likely lead some schools with low borrowing rates to stop offering federal student loans. It can be calculated now using data already available to the Education Department. And it is as more salient data point for consumers since it conveys the actual average risk of defaulting for any given student.

Using dollar-based cohort default rates (percentage of dollars in default) to trigger risk-sharing would not effectively measure a student's risk from enrolling in a school for two reasons. First, like the CDR, it excludes entirely students who enrolled without borrowing, and therefore are not at risk of default. Second, dollar-based rates are not an appropriate measure of borrowers' risk because the consequences of default are severe no matter what the borrowers' balance is.

Loan repayment rates (percentage of borrowers who are current and paying down principal on their loan) are a potentially valuable metric, but using them would delay implementation of risk sharing significantly because loan repayment rates are not currently calculated for colleges. It would also be much more difficult to select appropriate thresholds for risk-sharing, rewards, and ineligibility because institutional loan repayment rates may vary significantly based on the degrees offered, regardless of institutional quality. Without currently available repayment rates, we cannot even begin to assess whether or how to implement risk sharing based upon them. In contrast, using SDRI does not require waiting for data to implement much-needed risk sharing.

The table below shows the current distribution of SDRI across the 4,516 colleges that disbursed Stafford loans, had borrowers who entered repayment in FY 2011, and reported a borrowing rate among undergraduates. Across all colleges, the average enrollment-weighted SDRI is 5.0%. Currently, 21% of these colleges (enrolling 13% of students) have SDRI between 10% and 20% and would be subject to risk sharing if their SDRI remained the same in 2019, the year we recommend risk-sharing begin. These schools have a median SDRI of 13.5%.

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loans, Grad PLUS loan borrowers should not need to be accounted for separately. We also recommend including private loans in the borrowing rate so that schools cannot lower their SDRI by getting students to take out private loans instead of federal loans. The Department does not currently have data on how many students at a school have private loans but no federal loans, so in order to include private loans in the borrowing rate, legislation will need to require that all private loans be certified by schools and that schools and the federal government be notified of the private loans disbursed to their students. Until the private loan data are available, the SDRI should be calculated based on Stafford loans only.

**Current Distribution of Schools and Enrollment by SDRI**  
(columns total 100, rounding issues excepted)

SDRI Range	Share of Schools				Share of Enrollment
	Public	Nonprofit	For-Profit	TOTAL	TOTAL
<b>At or below 2%</b>	22%	25%	8%	18%	27%
<b>2.01-5%</b>	33	37	14	27	35
<b>5.01-10%</b>	31	26	29	29	23
<b>10.01-15%</b>	9	7	22	13	9
<b>15.01-20%</b>	3	3	16	8	4
<b>20.01-25%</b>	1	1	7	4	1
<b>&gt;25%</b>	0	1	4	2	0

Note that SDRIs do not provide a system of accountability for schools that do not offer federal student loans (this also is true for CDRs currently). A different accountability system is needed for schools that do not offer loans.

### *What Triggers Risk Sharing for a College? An SDRI of 10% or Higher*

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The average SDRI across all colleges is currently 5.0%. Once risk sharing has been phased in, we recommend the following risk-sharing and risk-reduction thresholds:

- **Ineligibility: Schools with an SDRI of 20% or higher** in a single year would not be eligible for federal aid. An SDRI of 20% – *four times* the current average SDRI of 5% – means that at least one in five students at that college are expected to end up in default. Because colleges that currently have high SDRIs would have time before sanctions are implemented to reduce their default rates, and because in future years colleges would be subject to risk sharing before their SDRI reached 20%, few colleges should ever reach this level. While many would argue that a default risk of 20% is too high of a threshold to end eligibility, it is clear that the threshold should be no higher than 20%.
- **Risk-sharing: Schools with an SDRI between 10% and 20%** in a single year would be required to make risk-sharing payments that would rise as their SDRI increased (ranging from 1% to 10% of either federal loan volume or total federal aid volume, depending on the schools' level of reliance on federal aid) to reflect the greater risk posed to students and taxpayers and to provide an incentive for schools to lower their SDRI.
- **Risk-reduction plan: Schools with an SDRI of 10% or greater** would be required to adopt a risk-reduction plan to lower their default rates (what the HEA currently calls a default management plan).<sup>2</sup> Under current law, schools are not required to adopt a plan until their CDR reaches 30%.

We recommend setting fixed thresholds rather than using “norm-referenced” thresholds that vary over time so that colleges can plan based on the fixed thresholds set in law.

<sup>2</sup> Note that 73% of colleges already have SDRIs below 10%.

### *What Is the Liability for a College? Risk-Reduction Plans and Risk-Sharing Payments*

Schools that have a SDRI of 10% or greater would be required to adopt a risk-reduction plan to reduce defaults based on an analysis of which students are defaulting at the school and why (the HEA does not require a “default management plan” until a school has a CDR of 30% or higher). Such schools would also have to make risk-sharing payments.

We propose that risk-sharing payments be calculated as a share of student aid as illustrated below.

- Schools with a *majority* of funding from federal student aid would pay a risk-sharing fee equal to a percentage of *all* federal student aid received.
- Schools that receive *less than half* of funding from federal student aid would pay a risk-sharing fee equal to a percentage of *their Stafford loan volume* (not of all their federal student aid).

#### How Risk-Sharing Amounts Are Determined

SDRI	Risk-Sharing Rate	Colleges with a <i>majority</i> of funding from federal student aid	Colleges with a <i>minority</i> of funding from federal student aid
>=10% and <11%	1%		
>=11% and <12%	2%		
>=12% and <13%	3%		
>=13% and <14%	4%		
>=14% and <15%	5%	Risk-sharing rate multiplied by <i>all</i> federal student aid	Risk-sharing rate multiplied by <i>Stafford loan volume</i>
>=15% and <16%	6%		
>=16% and <17%	7%		
>=17% and <18%	8%		
>=18% and <19%	9%		
>=19% and <20%	10%		

We recommend that all risk-sharing payments be placed in a federal account managed and operated by the Education Department to help fund the following: loan discharges because of school closures, false certification, or other fraud; student financial aid; and improvements in loan counseling.

Why risk-sharing payments should not be tied to defaulted loan amounts. Risk-sharing payments should not be calculated based on the amount of *defaulted* debt. Defaulted amounts are often very low since non-completers are among the most likely to default and students often drop out quickly before they have accumulated much debt. Thus, basing payments on the amount of defaulted loans may create a low base for determining risk sharing payments relative to the amount of federal aid the school is receiving, providing less of an incentive for schools to help keep borrowers – and the borrowers at highest risk of default, in particular – in good standing.

## *Offering Rewards for High Performing Colleges*

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It is very important to complement risk-sharing with rewards for colleges that serve students well.

We propose that to be eligible for SDRI rewards, colleges must have had a SDRI calculated in the last two consecutive cohort years.<sup>3</sup> This requirement gives schools an incentive to offer federal loans and ensures that schools just starting to offer loans are not rewarded before they have a track record.<sup>4</sup>

We recommend the following SDRI thresholds for colleges to receive financial and non-financial rewards:

- **For financial rewards: an SDRI of 2% or lower** in a single year would result in the college being rewarded with additional flexible need-based grant aid, similar to the current federal Supplemental Educational Opportunity Grant (SEOG). The amount of additional funding each college receives would be based on the amount of Pell Grant dollars disbursed to their students, which will help encourage colleges to enroll low-income students, help them apply for aid, and support them in enrolling full time. Colleges should have flexibility in how they award the additional funds, similar to SEOG and other existing campus-based aid programs. If \$800 million were provided for rewards, based on SDRIs using the most recent official CDRs, colleges with SDRIs at or below 2% would receive roughly \$750 per maximum Pell Grant award. At the same rate, rewarding colleges with SDRIs at or below 5% at the same rate would cost roughly \$2.1 billion.<sup>5</sup>
- **For non-financial rewards: an SDRI of 5% or lower** in a single year would result in the college being eligible for non-financial rewards, including greater flexibility to innovate. Options could include eligibility or preference for Experimental Sites experiments, added points in funding competitions, and reduced likelihood of being selected for program reviews. Although a school's own policies, practices, and systems may be a greater obstacle to innovation, federal student aid policies can also be a barrier to finding new ways to provide greater access to a quality education at a lower cost. Precedent exists for providing colleges with greater flexibility based on their track records. For example, under current law, schools with lower default rates are given greater flexibility in the disbursement of student loans.<sup>6</sup> In addition, nonprofit and for-profit colleges with strong financial responsibility scores are subject to less oversight and

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<sup>3</sup> To avoid rewarding colleges with low borrowing rates but very high default rates, Congress could limit rewards to schools with SDRIs at or below 5% and CDRs below 30%.

<sup>4</sup> For example, nearly one million community college students nationally in 2013-14 were enrolled in schools that did not participate in the federal loan program. See TICAS, 2014, *At What Cost? How Community Colleges That Do Not Offer Federal Loans Put Students at Risk*. <http://ticas.org/content/pub/what-cost-how-community-colleges-do-not-offer-federal-loans-put-students-risk>

<sup>5</sup> Calculations by TICAS using data from the U.S. Department of Education: FY11 three-year CDRs, 2011-12 undergraduate borrowing rates, and 2011-12 Pell Grant volume. Colleges with no students entering repayment in the FY11 cohort and those that did not disburse Stafford Loans in 2011-12 were excluded from the estimates. For colleges with an SDRI at or below two, we divided their total Pell disbursements by the size of the maximum 2011-12 Pell Grant (\$5,550) and then multiplied by \$750, for a total of \$799 million.

<sup>6</sup> For example, schools with a CDR of less than five percent are eligible to make single and nondelayed disbursements of loans for attendance in a study-abroad program. Schools with default rates of less than 15 percent are not required to delay the delivery or disbursement of loans for 30 days for first-time, first-year undergraduate borrowers. For more information, see <http://ifap.ed.gov/DefaultManagement/finalcdrg.html>.

monitoring than schools with lower financial responsibility scores.<sup>7</sup> However, these examples are exceptions to the general rule of a one-size-fits-all approach to regulation and oversight, which tends to overregulate the best colleges and under-regulate the worst.

### *Phased Implementation Schedule*

We recommend giving schools time to prepare and lower their default rates before they are sanctioned based on their SDRI. Specifically, as illustrated in the table below, schools would not be sanctioned or required to make risk-sharing payments based on the SDRI until 2019 for the 2016 cohort, which has not yet entered repayment (and won't enter repayment until October 2015). In the meantime, we recommend implementing a lower-stakes consequence right away – requiring risk-reduction plans for schools with SDRI of 10% or greater – to help get schools used to the concept of the SDRI and help them lower their default rates before sanctions are implemented. We also recommend implementing rewards right away to provide an incentive for schools to offer federal loans and further lower their default rates, and to reward schools that serve students well and encourage them to enroll low-income students.

#### **Phased implementation schedule, transitioning from current CDR rules to the new SDRI rules**

Cohort Year	Metric Used	Threshold for ineligibility	SDRI threshold for required risk-reduction plan	SDRI threshold for risk sharing	SDRI threshold for rewards (CDR must also be below 30%)	Timing of any sanctions and rewards
<b>FY 2012</b>	CDR	=>30% for 3 yrs	N/A	N/A	N/A	Fall 2015
<b>FY 2013</b>	CDR	=>30% for 3 yrs	=>10%	N/A	<=2% for \$ rewards <=5% non-\$rewards	Fall 2016
<b>FY 2014</b>	CDR	=>30% for 3 yrs	=>10%	N/A	<=2% for \$ rewards <=5% non-\$rewards	Fall 2017
<b>FY 2015</b>	CDR	=>30% for 3 yrs	=>10%	N/A	<=2% for \$ rewards <=5% non-\$rewards	Fall 2018
<b>FY 2016 and beyond</b>	SDRI	=>20%	=>10%	10-20%	<=2% for \$ rewards <=5% non-\$rewards	Fall 2019

<sup>7</sup> For more information on the relationship of financial responsibility scores to levels of oversight, see <http://studentaid.ed.gov/about/data-center/school/composite-scores>.