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News from NASFAA

What's in a Cohort Default Rate?

Washington, D.C. (August 2007) – After a rough summer for the student loan industry, the Department of Education, Lenders, Guarantors and Institutions all had something to cheer about when the Department released the 2005 Cohort Default Rates (CDRs).

The rates showed that only 4.6 percent of borrowers who began repaying their loans between October 1, 2004 and September 20, 2005 had defaulted on their loans by September 2006. The rate had dropped half a percentage point from 5.1 percent the previous year and was only .1 percentage point higher than the historically low rate announced in 2005.

Guaranty agencies around the country issued press releases touting the low number as well as the low numbers at their agency. American Student Assistance (ASA) had a 1.5 percent CDR in 2005, the lowest of any of the 35 guaranty agencies in the country.

“We are proud of this accomplishment, especially of our sustained ability to continue to set new default prevention standards year after year,” said Paul Combe, ASA president and CEO. “These results show that ASA's borrower focused business model is good public policy and makes ASA stand out from the pack when it comes to helping borrowers successfully manage education debt.”

However, some were not that impressed by the low default percentages posted this year. Their central complaint is that the Cohort Default Rate does not provide an accurate indication of students' success in repaying their loans. Alan Collinge, president of Student Loan Justice.Org, an advocacy group for borrowers, argues that the CDR only represents a slim slice of the total default pie.

“The cohort rate is a silly metric that only counts the loans that default in the fiscal year after the fiscal year in which the borrowers entered repayment,” Collinge says. “The true default rate is roughly triple this number - between 12 and 15 percent, depending on the type of loan.”

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Collinge's argument is nothing new. In December 2003 the Department's Office of the Inspector General released a report, concluding that the CDRs "do not appear to provide decision-makers with sufficient information on defaults in the Title IV loan programs."

The Department noted that the 2005 low default rates are a result of a record number of loan consolidations, as well as forbearance and deferments granted to victims of hurricanes Katrina and Rita, but it remains unknown how well these borrowers will be able to avoid default in the coming years.

The skepticism about the CDR as an accurate gauge of students' ability to avoid default raises the question: Why is this statistic used as the standard for measuring default and to determine what lenders and institutions are eligible to participate in the Title IV programs?

The Department was concerned in 1987 that increasing student loan default costs were undermining public confidence in the loan programs and instituted several measures to reduce defaults. One of these measures was regulations issued to hold schools responsible for keeping default rates of borrowers who attended their institutions below a specified threshold for the first two years of repayment.

Then Congress changed the definition of default when they reauthorized the Higher Education Act (HEA) in 1998. The 1998 HEA bill changed the definition of default from a 180-day delinquency to a 270-day delinquency.

Under the current 270-day definition of default, it takes about 420 days for a borrower to be considered in default. Since 420 days is more than a year, it is possible for some borrowers who enter repayment late in a CDR year to make no payments and still not be considered in default for that cohort default year, according to the inspector general's report. Under the 180-day delinquency definition, this could not occur because the delinquency period was less than a year, ensuring that all borrowers who did not make any payments were considered in default during the appropriate cohort year.

When borrowers default outside of the cohort default year, it can skew the cohort default rate even more because these borrowers are considered in the repayment base but not in the default base, inflating a low default rate more than if the borrower was never considered at all.

Why would Congress make this change?

According to the inspector general's 2003 report, the change was one of several savings measures enacted to offset the cost associated with changing the formula for lenders' student loan interest subsidies. The Congressional Budget Office estimated that the definition change would reduce the outlays associated with defaulted loans by \$880 million for the period 1998 to 2008.

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Many (including the Office of the Inspector General) have argued that the Department should track a life of loan cohort default rate to supplement or replace the current CDR in order to provide a more accurate portrait of student loan default.

ASA’s Vice President of Borrower Services Michael Ryan said ASA agrees that the cohort default rate alone is not a sufficient indicator for evaluating defaults, and that the company supports tracking lifetime defaults.

While the current CDR may not be a perfect measure of default, it still provides a glimpse of the majority of students that enter repayment in a cohort year. The fact that the CDR has dropped from 22.4 percent in 1990 to 4.6 percent today should be a feather in the cap of all those who work hard to prevent borrowers from defaulting.

“The cohort default rate calculation does have some value in helping assess effectiveness in preventing defaults right out of the box,” Ryan said. “Some measure of how early-stage repayers are doing has value, as this is the most critical juncture in getting borrowers on track successfully. Statistics show that borrowers who make monthly payments on time in the first year of repayment are much less likely to default later on.”

By Haley Chitty, Assistant Director for Communication, NASFAA. Haley may be contact at ChittyH@NASFAA.org.

The National Association of Student Financial Aid Administrators (NASFAA) is a nonprofit membership organization that represents more than 13,000 financial aid professionals at nearly 3,000 colleges, universities and career schools across the country. Based in Washington, D.C., NASFAA is the only national association with a primary focus on student aid legislation, regulatory analysis, and training for financial aid administrators. Each year, members help more than 8 million students receive funding for postsecondary education. In addition to its member Web site at www.NASFAA.org, the Association offers a Web site with financial aid information for parents and students at www.StudentAid.org.

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[Editor: A photograph of the author is available for download online:

Low Resolution - <http://www.nasfaa.org/Subhomes/MediaCenter/HaleyChittyPhoto-LowRez.jpg>

High Resolution - <http://www.nasfaa.org/Subhomes/MediaCenter/HaleyChittyPhoto-HiRez.jpg>]