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Student Loan Cohort Default Rates: Exemptions for Certain Minority Serving Institutions

Charmaine Jackson
Analyst in Social Legislation
Domestic Social Policy Division

Summary

During the 1980s federal student loan defaults were on the rise. Congress responded with various legislative measures intended to curb the number of defaults. In 1990 Congress began holding higher education institutions responsible for their student loan cohort default rates. Institutions that meet or exceed a 25% threshold for each year in a three-year period are ineligible to participate in the federal student loan program and the Pell Grant program. Historically black colleges and universities and certain tribally controlled colleges and universities have been exempted from the penalties for exceeding the cohort default rate thresholds. This exemption is scheduled to expire in June 2004. This report will be updated as warranted.

Introduction

During the 1980s federal student loan default rates increased significantly. For example, in FY1988, the national student loan cohort default rate was 17.2%, and increased to an all time high of 22.4% in FY1990. As a result, the federal government was assuming a large share of the burden associated with the defaulted loans. In response largely to the increasing default rates and the associated costs, Congress passed a series of measures intended to decrease the number of defaults, deter students from defaulting on their loans, and hold institutions accountable. One of these acts was the Student Loan Reconciliation Amendments of 1989 (P.L.101-239). This act was the first time Congress based institutional eligibility to participate in the federal student loan program on the institution's default rate. In the following year, Congress passed the Omnibus Budget Reconciliation Act (OBRA) for FY1990 (P.L. 101-508), which made the aforementioned institutional requirement effective through FY1996, and established maximum cohort default thresholds (defined below) for continued participation in the federal student loan

program.[1] OBRA of FY1990 exempted historically black colleges and universities (HBCUs), as defined by Title III, Part B of the Higher Education Act (HEA), and tribally controlled colleges and universities (TCCUs), as identified by the Tribally Controlled Community College Assistance Act and the Navajo Community College Act from the cohort default rate thresholds. The rate definition and exemption definition have both been revised and extended since 1990. Presently the exemption for these schools is scheduled to expire in June 2004.

Cohort Default Rates

Definition

Currently, one criterion for institutional eligibility for Federal Family Education Loans (FFEL), Direct Loans (DL) and the Federal Pell Grant program is the institution's cohort default rate. A *cohort* is defined as the group of federal student loan[2] borrowers entering repayment during a fiscal year (e.g., October 1, 2002 to September 30, 2003). The *cohort default rate* (CDR)[3] is the percentage of borrowers defaulting[4] during that year and the subsequent fiscal year (e.g., defaulted between October 1, 2002 to September 30, 2004).[5] The cohort default rate for institutions having 30 or more students entering repayment in a fiscal year is calculated by dividing the number of defaulted borrowers by the number of borrowers entering repayment in that same period; this calculation is known as the *non-average rate formula*. However, for an institution that has 29 or fewer students in repayment, its cohort default rate is calculated by *aggregating* data over the three most recent fiscal years. The *average rate formula* uses the number of borrowers who entered repayment in the current fiscal year and the two preceding fiscal years and defaulted as the numerator and the number of borrowers who entered repayment in the current fiscal year and the two preceding fiscal years as the denominator.

Institutional Consequences

If an institution has a CDR of 25% or more for each year during the three most recent fiscal years (i.e., 2001, 2002 and 2003) it is ineligible to participate in the federal student loan programs and in some instances the Pell Grant program.[6] In addition to the loss of

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[1] For additional reading on the federal student loan programs please see CRS Report RL30048, *Federal Student Loans: Program Data and Default Statistics* by Adam Stoll.

[2] For the purposes of this paper, the federal student loan programs include Federal Family Education Loans (FFEL) and William D. Ford Federal Direct Loans (DL).

[3] In accordance with HEA, Title IV, Section 462(g)(1)(A).

[4] A loan is considered to be in default after 270 days of delinquency.

[5] Institutions are only required to report the repayment status for a federal student loan for the first two years of repayment.

[6] According to CFR 668.187(e) an institution can continue to participate in the Pell Grant program if: it was ineligible to participate in FFEL and Direct Loan programs before Oct. 7, 1998, and its eligibility was not reinstated; or the institution did not certify an FFEL loan or (continued...)

eligibility for a cohort default rate of 25% or higher for three years, an institution that has a cohort default rate of 40% or more for the most recent *fiscal year* loses its eligibility to participate in the federal student loan programs. Except for extenuating circumstances and/or a successful appeal, an institution that loses its eligibility in either case remains ineligible to participate in the programs for the remaining part of the fiscal year in which it was notified, and for the two subsequent fiscal years.

HBCUs and TCCUs are exempt from maintaining a cohort default rate of less than 25% for a three-year period. It is important to note that these institutions are not exempt from the 40% CDR threshold, and can be ineligible to participate in the federal student loan programs as a result. If one of these designated institutions does have a CDR of 25% or more for each year in the preceding three fiscal years, it can continue to participate in the federal student loan program and Pell Grant program if, by July 1 of the year that it is notified of its loss of eligibility, it submits a default management plan and proof that it has engaged an independent third party to assist with the implementation of this plan. The default management plan and the third-party engagement were a part of the 1998 Higher Education Act Amendments (P.L. 105-244). In addition, the amendments specified that an institution that relied upon the exemption to remain eligible to participate in the Title IV programs was required to demonstrate how it would lower its CDR to less than 25% by July 1, 2002. The Consolidated Appropriations Act of 2001 extended the cohort default rate exemption from June 2002 to June 2004 (P.L. 106-554).[7]

Management Plan

Institutions with CDRs at or above 25% for each of the three most recent consecutive fiscal years and that wish to participate in the federal student loan program and the Pell Grant program must submit a default management plan. The plan must contain specific assurances, including but not limited to:

- Delineation of the appropriate personnel and resources that have been solicited to implement the default management plan.
- Proof that a default management team has been assembled, and that the team includes the chief executive officer, and other relevant senior executives and administrative offices, other than the financial aid office.
- Development of an evaluation approach to collect data to measure and verify relevant default statistics.

Upon submission and approval of the default management plan by the U.S. Department of Education (ED), the institution must annually submit evidence it has implemented the approved default management plan; is making *substantial improvement* in reducing the CDR; and that it continues to work with an independent third party. According to

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[6] (...continued)
originate a Direct Loan Program loan on or after July 7, 1998; or the institution requested in writing, before Oct. 7, 1998, to withdraw from participation in the FFEL and Direct Loan programs.

[7] According to H.Rept. 106-665 (H.R. 4504) the Committee extended the exemption until June 2004 because the June 2002 deadline did not provide sufficient time for the institutions to implement the proposed actions from the default management plan.

program regulations at 34 CFR Part 668.198, substantial improvement is determined by the institution's ability to demonstrate improvement in the following areas:

- a reduction in the most recent draft (preliminary) or official cohort default rate;
- an increase in the percentage of delinquent borrowers who avoid default by using deferments, forbearances, and/or job placement assistance;
- an increase in the academic persistence of its student borrowers;
- an increase in the percentage of students pursuing graduate or professional study;
- an increase in the percentage of current addresses of its borrowers that the institution has available;
- an increase in the percentage of delinquent borrowers the institution has contacted;
- the implementation of alternative financial aid award policies and the development of financial resources that reduce the need for student borrowing;
- an increase in the percentage of accurate and timely updates made to the National Student Loan Data System.[8]

The option of a default management plan is not applicable for institutions that have a cohort default rate of 40% for the most recent fiscal year.

Institutional Incentives

Institutions with *low* cohort default rates were previously eligible for various special incentives. For example, prior to September 2002, an institution whose most recent CDR was less than 10% could also deliver or disburse student loan proceeds in a single installment to a student if that student's loan period was less than or equal to one semester, one trimester, or one quarter. In addition, these institutions could choose not to delay the delivery or disbursement of the first installment of loan proceeds for first-year first-time borrowers. Both of these institutional incentives expired on September 30, 2002.

Status of Exemption

During the two most recent cohort default rate periods (FY2001 and FY2000) for which data are available none of the HBCUs or TCCUs had to rely upon the exemption to remain eligible to participate in the federal student loan and Pell Grant programs.[9] Data from the five previous cohort default rate periods indicate that the cohort default rates at

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[8] The National Student Loan Data System is the U.S. Department of Education's central database for student aid. It receives data from schools, guaranty agencies, the Direct Loan program, the Pell Grant program, and other U.S. Department of Education programs.

[9] For additional information regarding institutional cohort default rates please refer to the U.S. Department of Education's, *Cohort Default Rate Guide*, available at [http://www.ifap.ed.gov/drmaterials/finalcdrg.html].

HBCUs and TCCUs have steadily decreased. For FY2001, 67 of the 124 (54%) participating HBCUs and TCCUs had CDRs of 10% or less, which would have made them eligible for the institutional incentives previously referenced. In addition, 49 (40%) of the institutions had CDRs between 10% and 19.9%. Only eight institutions (6%) had rates of 20% or higher for FY2001.

When the extension was granted for HBCUs and TCCUs from 2002 to 2004, the House Committee Conference report indicated that the exemption was originally granted to these institutions because of their historical commitment to serving students who might not otherwise attend college (H.Rept. 106-665). Moreover, the General Accounting Office (GAO) released a report entitled, *Student Loans: Characteristics of Students and Default Rates at Historically Black Colleges and Universities* (GAO/HEHS-98-90), that discusses research on the characteristics of students who are most likely to default on their student loans. Specifically, the report states that students with less academic preparation and those who come from families with lower incomes are more likely to default on their student loans. The report further states that HBCUs tend to enroll larger percentages of students from both of these groups: a possible explanation for why these institutions may have needed in the past to rely upon the exemption to the cohort default threshold to continue participating in the federal student loan and Pell Grant programs.

As the exemption is scheduled to expire in a few months, the Congress may consider the following questions: Should the exemption be extended to continue to provide a "fail safe" for HBCUs and TCCUs that serve many disadvantaged students, or has the recent data on cohort default rates at these institutions illustrated their ability to make good use of the exemption period and therefore the exemption is no longer necessary?