HigherEDGE® | Default Management Solutions

TAMING THE DEFAULT RATE BEAST

Strategies for implementing a successful default management program

HigherEDGE®
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About HigherEDGE®

HigherEDGE is TG's suite of fee-based offerings that go beyond TG's existing school support services. HigherEDGE solutions provide your school with outsourcing options that maximize efficiencies, reduce administrative burden, and are cost-effective.

About TG

TG promotes educational access and success so that students can realize their college and career dreams. As a nonprofit corporation, TG offers resources to help students and families plan and prepare for college, learn the basics of money management, and repay their federal student loans.

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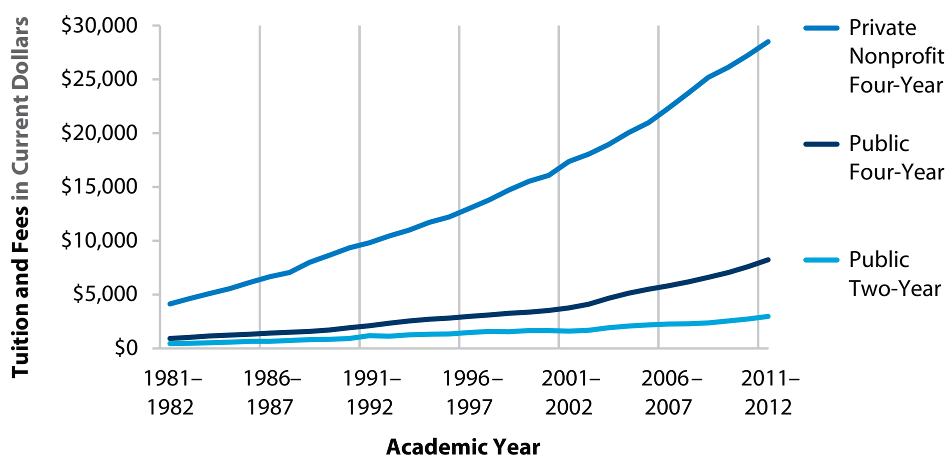
EXECUTIVE SUMMARY

Rising student loan cohort default rates (CDRs) are a growing concern among institutions that rely on Title IV funding to provide much-needed federal financial aid for a steadily increasing proportion of students. If their default rates are too high, institutions can lose access to funding. How can schools, faced with demanding workloads and limited resources, implement a cost-effective default management program? This paper outlines strategies that schools can use to help set students on the path to repayment success. The campus-wide program detailed in this paper works to improve an institution's CDR by providing borrowers with the knowledge, skills, and determination they need in order to reach this goal. It presents a holistic approach that addresses each phase in the life of a student loan, tools that can help, and the basic elements involved in performing a cost–benefit analysis of the required set of default aversion activities.

What's the answer to rising cohort default rates?

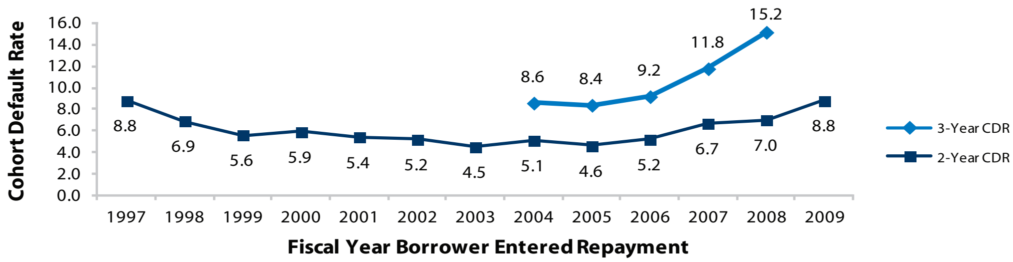
A number of factors have converged in recent years to create significant barriers to successful student loan repayment. These include increased unemployment, a lagging economy, rising college costs and student borrowing, higher consumer debt-to-income ratios, and dwindling support from exiting industry players. Cohort default rates (CDRs), the measure used by the Department of Education (ED) to determine whether an institution's student borrowers are successful at repaying federal student loans, have been increasing rapidly. Furthermore, a recent lengthening of the monitoring period used to calculate CDRs has shed light on the fact that incidents of default increase dramatically in the third year after repayment begins.

Figure 1: Average Published Tuition and Fees in Current Dollars, 1981–1982 to 2011–2012



Source: 1987–1988 and after: Annual Survey of Colleges, the College Board, weighted by full-time undergraduate enrollment; 1986–1987 and prior: Integrated Postsecondary Education Data System, U.S. Department of Education, National Center for Education Statistics, weighted by full-time equivalent enrollment.

Figure 2: National 2- and 3-Year Cohort Default Rates (FY 1999–2009)



Source: U.S. Department of Education

Repayment success, whether defined as annual principal reduction or payment in full by every borrower, is about more than just preventing default. ED has in recent years been moving to enlist additional measures of repayment success by focusing not only on whether a student borrower ultimately defaults on his or her loan(s), but also on whether that borrower can begin to reduce the principal balance owed within four to five years of leaving school. While seemingly a benign measure, early data shows that a surprisingly large number of borrowers fall short of achieving even that, and, instead of making payments, end up in a repeating cycle of forbearance and delinquency. These results point to a fundamental disparity between the cost and resultant debt burden of some higher education programs and the earnings that can be expected to result from them.

With over $105 billion in federal loans awarded in the last federal fiscal year and more than $1 trillion in total loans outstanding — more than the total amount of outstanding credit card debt in the U.S. — education debt comprises a larger proportion of the American economy than ever before. If repayment rates continue to suffer and default rates continue to climb, it seems likely that the discussion of students' lack of success in repaying that debt will grow louder, more intense, and more polarizing in the coming years.

Why should institutions of higher learning focus on repayment success?

Faced with tightening budgets and increasing competition for resources, many institutions struggle with prioritizing repayment success. For a number of reasons, however, administrators cannot afford to ignore this growing problem. Because increasing student loan defaults and slumping repayment rates ultimately result in increased servicing, collections, and other costs to taxpayers, the federal government has placed increased responsibility for avoiding these costs on Title IV institutions by lengthening the CDR calculation period.

In brief, a cohort is a group of federal Direct and Stafford loan borrowers who enter repayment within a given federal fiscal year. The CDR is the percentage of borrowers in a school's cohort who default within either the next two or three fiscal years after entering repayment. Under the most recently instituted sanctions, a school can lose the ability to disburse all Title IV aid if its 3-year CDR is greater than 30% for three fiscal years in a row. Additionally, an institution can lose eligibility to disburse loans, but not necessarily Pell grants, if its 2- or 3-year CDR is greater than 40% for one year. Given that many institutions and their students rely on Title IV aid as their primary funding source, losing the ability to disburse federal aid could mean the loss of jobs for faculty and staff and of educational opportunities for many students, since many schools in this circumstance would be forced to close. This is not a risk most institutions can afford to ignore.

Even if an institution's CDR is not currently high enough to put it at risk of losing aid, other factors compel schools to pay close attention to student repayment. As the dialogue around growing student loan debt increases, so too does the level of attention applied by the media and watchdog organizations; this is especially the case within the for-profit education sector. With increased scrutiny comes the increased risk of negative publicity and damaged reputations. There are also practical benefits to minimizing student defaults. Just as schools incur penalties for high CDRs, they can enjoy benefits for low CDRs, such as the ability to make single disbursements and avoid holds on loans to first-time students. These benefits result in increased operational efficiencies and cost savings within the financial aid function.

Ultimately, however, student loan repayment is of utmost importance for one group: borrowers. With over $1 trillion in loans outstanding to millions of borrowers, the increasing trend of student loan default runs the risk of frustrating the progress of a generation of students. Recent studies have shown that student borrowers with high debt levels feel burdened by this responsibility, and have a greater tendency to postpone significant life events, such as marriage (Gicheva, 2011; Hendel, 2011; Rothstein & Rouse, 2011). If the mission of schools is to prepare students to succeed in their professional endeavors, and thereby improve their life circumstances, then it is incumbent upon them to provide students with the resources they need to succeed in repayment once they leave school.

So how can we begin to improve repayment success?

Upon leaving school, many of today's student borrowers lack the fundamental skills required to repay their student loans successfully. Faced with daunting challenges like seeking employment and adjusting to a new lifestyle, and lacking a solid grounding in principles of personal finance, borrowers choose to ignore their student loan obligations in order to focus on more immediate needs. Despite the efforts of financial aid professionals, federal loan servicers, and, in some cases, third parties to educate borrowers on their options, they withdraw from those who are offering assistance in the hope that the problem will go away. Unfortunately, when borrowers decide to avoid the issue in the earliest stages of delinquency, the battle is often already lost. The larger war can still be won, however, through dedicated effort. Schools must institute a program that provides borrowers with the knowledge and ability they need, so that those who are committed to repayment are able to achieve success.

Above all, borrowers need to build knowledge about managing their personal finances and the student loans they depend on to help pay for the cost of education. Lacking basic personal finance skills like budgeting and money management, many fail to consider the magnitude of monthly payment obligations that will come to bear after they leave school. Thus, instilling financial fundamentals through an effective financial literacy program is a key strategy for success. Such a program would demonstrate monthly budgeting techniques and explain the appropriate use of the various types of consumer credit.

Additionally, providing a student loan calculator that can give borrowers a realistic picture of their potential student debt burden after school can encourage on-time completion and help keep over-borrowing to a minimum. Finally, material that presents a basic summary of the available federal student loan repayment plans (such as Income-Based Repayment, Extended Repayment, and Graduated Repayment, among others) can help mitigate fear and uncertainty in the minds of borrowers.

Borrowers need and deserve the ability to repay successfully. This ability comes not only through the intrinsic benefits of a higher education or advanced training program, but also through exposure to promising employment opportunities that provide an appropriate level of earnings relative to acquired debt. Analyzing these elements reveals several opportunities to generate repayment success. Routinely examining total program costs and completion requirements can help identify potentially unnecessary inhibitors to on-time completion; higher on-time completion results in less over-borrowing. Actively monitoring local and regional employment trends and then adjusting the mix of offered programs helps align the availability of the workforce with market demands, ultimately resulting in a greater percentage of positive employment outcomes. Additionally, analysis of placement rates, starting salaries, and opportunities for career re-education can assist in further refining the output mix and promoting the appropriate earnings levels that students need to start down the path to repayment success.

The last, and potentially most challenging, requirement for achieving repayment success involves instilling within borrowers a commitment to repay. Financial literacy training that teaches students to distinguish between needs and wants — and that underlines the consequences of default — can help engender this resolve. So can taking steps to make sure students feel integrated into campus life, and are on track to complete their degrees successfully. Studies have shown that feelings of integration into campus life and connectedness to the institution increase retention and graduation rates (Schreiner, 2009; Tinto, 1993), reducing in turn the risk of default (McMillion, 2004; TG, 2006).

With so many competing priorities and limited resources, how can institutions provide the knowledge and ability committed students need?

Giving student loan borrowers the tools they require to achieve successful repayment can be a daunting task. No single individual or department on campus can be reasonably expected to deliver each of these elements, particularly on a stand-alone basis. Therefore, we recommend the implementation of a holistic, campus-wide default management and repayment success program, one that starts early and provides consistent borrower interaction and education throughout the life of the student loan.

The first step in implementing a comprehensive program of this nature is the establishment of a campus-wide default management committee and a cohesive default management plan that is dedicated to achieving the benefits of repayment success and avoiding the consequences of default. TG's 2004 paper, *Breaking New Ground*, recounts the story of seven historically black colleges and universities (HBCUs) in Texas that formed a default management consortium in response to a 1998 Congressional amendment of the Higher Education Act lifting the CDR exemption for HBCUs. Each of the consortium members was able to significantly reduce CDRs over a period of several years. The paper credits much of the success at each institution to two key strategies: the formation of an oversight taskforce that included faculty, staff, and, most importantly, administrators, and the implementation of a specific default management plan that included borrower education, communication, and data analysis.

Additionally, the paper discusses the advantages of designating a default prevention manager strictly dedicated to "coordinating campus-wide implementation of the default management plan" and executing the plan on a daily basis (TG, 2004, p. 10). While these commitments require the dedication of time and often-scarce resources, the implementation of a defined set of default management activities, under the direction of the committee and the default manager, can deliver invaluable benefits to both institutions seeking to improve overall repayment success and those faced with the potential loss of Title IV aid due to an elevated CDR.

Equally as important as the types of activities conducted as part of a comprehensive plan are the sequence and timing of those activities. The lifecycle of a student loan can be divided into three distinct phases: the in-school period, the grace period — the six month period after enrollment ends during which no loan payments are due — and the repayment period, during which borrowers can become delinquent and subsequently default. Each phase presents a specific set of opportunities for borrower education and engagement, as illustrated by the following sets of best practices.

Table 1: In-School Period

These activities can be conducted while borrowers are still enrolled.

Activity	Potential Benefits
Conduct in-person entrance and exit counseling	• Builds a stronger connection between borrowers and the institution • Encourages understanding of the rights and responsibilities of a student borrower • Affords additional opportunities to gather supplemental contact information
Gather supplemental contact/reference information at the beginning of each academic period	• Increases the likelihood of successful contact with borrowers after they leave the institution
Conduct interim counseling that challenges borrowers to consider projected future debt vs. expected future income as part of the counseling session	• Reduces over-borrowing and encourages on-time completion • Encourages continued evaluation of academic career path relative to future employment expectations
Provide financial literacy training as part of freshman experience or other first-year courses	• Lays foundational framework of personal finance and money management skills • Provides another opportunity to reinforce the future impact of expected earnings vs. future debt
Implement a faculty-based "early warning" system to identify and provide additional outreach to borrowers at risk of academic failure	• Provides additional support to borrowers most at risk of future delinquency and default
Encourage active participation in career services	• Increases career placement rates, improving probability of individual repayment success • Provides data necessary for the ongoing evaluation of the types of programs and training offered by the institution

Table 2: Grace Period

Early and frequent contact during the grace period has been shown to be an effective strategy for preventing future delinquency and default. In one study, borrowers who received proactive "grace counseling" were shown to be up to 15 percentage points less likely to subsequently become delinquent (TG, 2012).

Grace Period Counseling (including active outbound phone call, letter, and email communications)	**Potential Benefits**
Encourage re-enrollment, if applicable	• Improves student retention rates • Encourages completion; borrowers who do not complete are more likely to experience delinquency and default
Review the National Student Loan Data System (NSLDS) and walk borrowers through summary loan information	• Provides a consistent location for summary loan information • Effectively illustrates total debt obligation (not including private or institutional loan information) • Provides servicer contact information
Educate borrowers about available repayment options	• Reduces fear and uncertainty about the feasibility of repayment
Encourage borrowers to update/maintain current contact information with servicers	• Increases likelihood of future contact with borrowers if delinquency occurs
Determine reasons for withdrawal and transfer. Categorize reasons and provide feedback to other areas on campus	• Assists other areas in identifying impediments to successful completion
Encourage active participation in career services	• Increases career placement rates, improving probability of individual repayment success • Provides data necessary for the ongoing evaluation of the types of programs and training offered by the institution

Table 3: Repayment (Potential Delinquency) Period

Activity	**Potential Benefits**
Actively monitor NSLDS and reach out to borrowers who are delinquent and in forbearance to provide resources and counseling	• Helps borrowers experiencing repayment challenges to understand the types of repayment plan options available
Offer career services to former students	• Provides data for additional analysis of the effectiveness of the types of programs offered by the institution
Work with servicers and/or third-parties to locate "skip" borrowers (those with no valid contact information on file)	• Increases the probability of contact with delinquent borrowers

By conducting default aversion activities when they are likely to be most successful, schools can fine tune their approach to default management and increase the likelihood of successful repayment.

What tools and services are available to assist in implementing a comprehensive approach to default management and repayment success?

Fortunately, schools can access a number of tools and services to assist in the creation and implementation of a holistic approach to default management. One such tool, designed to address each phase in the life of the student loan, is TG's Default Management Self-Assessment Tool, an online survey form schools can use to evaluate current institutional default management processes and goals, identify areas of strength and opportunities for improvement, compare recent CDRs with other institutions in the same school segment, and learn more about effective default aversion strategies. Some of the topics discussed include the overall institutional approach to default management, CDR trends, enrollment management practices, counseling techniques for current students, strategies for contacting borrowers in repayment, and engagement with on-campus and off-campus entities. The results of the assessment help identify specific areas of focus. The free tool can be found online at **www.TG.org/default-prevention/assessment.cfm**.

Another such tool, designed to assist with activities during the grace and repayment/delinquency periods, is TG's Integrated Default Assistant℠ (IDA℠). IDA allows certain users to import data from a variety of sources — including NSLDS, federal loan servicers, and guarantors — in order to analyze delinquency and default rate trends, communicate with borrowers via email and letter, and maintain a record of default management activities. Users can prioritize borrower contact efforts by delinquency level, loan type, grade level, enrollment status, and more, and can create customized letter templates for specific borrower groups. The tool contains a number of useful reports on topics such as CDR trends, delinquency rates, and servicer performance that can be used to summarize important information about a school's CDR situation. More information on IDA can be found online at **www.TG.org/products/ida/index.cfm**.

In addition to electronic tools, a growing number of third-party providers are available to assist with the most fundamental default management efforts, including designing and executing communication campaigns, conducting phone-based "grace counseling" sessions, and working directly with borrowers to help bring delinquent loans back into good standing. Schools faced with rising CDRs, growing populations of borrowers entering repayment, and budget or staff limitations may consider working with a third party in order to achieve some of these benefits:

- Ready access to technology and resources that can create operational efficiencies and cost savings
- Flexible staffing available on an as-needed basis, reducing overhead costs
- Quick access to qualified industry experts who can help navigate complex laws and regulations
- Outsourced management and execution of routine tasks, freeing internal staff to spend more time delivering personalized customer service

How can administrators determine the appropriate allocation of resources to address the problem?

The development and implementation of a comprehensive repayment success and default management strategy can require significant resources. As one might imagine, the resource requirement scales with both the size of the cohort and the current default rate situation. Institutions with higher default rates will need to engage in more frequent activities across the entire the life-of-the-loan cycle, conducting outreach with former students who are in their grace period or have already entered repayment in order to reduce short-term delinquency rates, and providing training and counseling for current borrowers in order to effect a longer-term positive shift in repayment behavior.

Recognizing that resources are limited, the allocation question quickly turns to a discussion of the points along the student loan lifecycle at which internal and external resources can be most effective. One increasingly common strategy involves tasking internal resources to target the in-school phase, thereby allowing campus-based staff to focus on educating current students. External resources, most often in the form of third-party providers, are then tasked with managing the grace and repayment periods with only moderate support from school-based personnel. It is not advisable, however, to turn the entire default management function over to a third-party organization, given that institutions ultimately remain responsible to ED for their default rates. In fact, the majority of the institutions involved in the HBCU consortium discussed in the *Breaking New Ground* paper focused internally on developing programs for and working with current students while partnering with an "independent third-party consultant" to work with former students (TG, 2004, p. 12).

Administrators will, of course, be acutely interested in the costs of enlisting additional resources and will likely want to see an analysis comparing the cost of internal vs. external resources. Some of the variables to consider in such an analysis include prior CDRs, current CDRs, future cohort default goals, the number of current delinquent borrowers, the required level of contact activity, and productivity estimates. For a calculator that can assist with this analysis, visit **www.HigherEDGE.net/Cost-Calculator**.

CONCLUSION

In a time of economic uncertainty, many federal student loan borrowers are struggling to repay their loans because they lack the knowledge, skills, and determination to repay successfully. Weak repayment rates and high CDRs can create serious consequences for institutions, up to and including the loss of Title IV funds. Schools can begin to have a positive effect on repayment by implementing a comprehensive approach to default management and repayment success that addresses each phase in the life of the student loan — in-school, grace period, and repayment — with specific activities designed to educate borrowers on basic personal finance skills, balancing educational debt with expected future income, and federal loan repayment options. A successful default management program can require significant resources. Engaging with third-party providers to help manage the process can garner benefits to the school by allowing campus-based staff to focus on working with current students to help create improvement in CDRs and a fundamental positive shift in repayment behavior.

For more information about TG's HigherEDGE, please visit **www.HigherEDGE.net**, call (800) 252-9743, or send an email to relationship.management@tgslc.org.

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