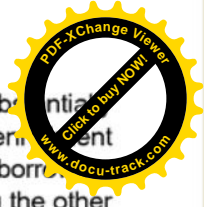
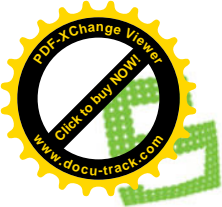


# SKewed STATISTICS

Uncovering the Implications of Student Cohort Default Rates

► Daniel L. Bennett | The Center for College Affordability and Productivity



student loan cohort default rates (CDR) have important policy implications for proprietary education. CDRs play a vital role in postsecondary education because schools must meet certain CDR standards to remain eligible for Title IV programs, which provide federal financial aid for students. In other words, if an institution fails to meet the established standards, then its students will not be eligible to receive federal grants or loans to finance their education. This would be the kiss of death in most cases.

An institution or sector's CDR is the ratio of the number of students who defaulted on their loan within a given period to the number of students who entered repayment during that same period. To be considered in default, a borrower must not have made a loan payment for 270 days if monthly payments are required, or 330 days if payments are scheduled on a less frequent basis. This generous definition gives students in repayment a considerable buffer against defaulting, yet CDRs have risen considerably in recent years and are highest in the proprietary sector. Critics have a right to be upset about data which revealed that more than one in five proprietary students defaulted on their student loan within three years of entering repayment. Still, a closer examination of the evidence suggests that proprietary education's CDRs are not as bad as they appear in the headlines.

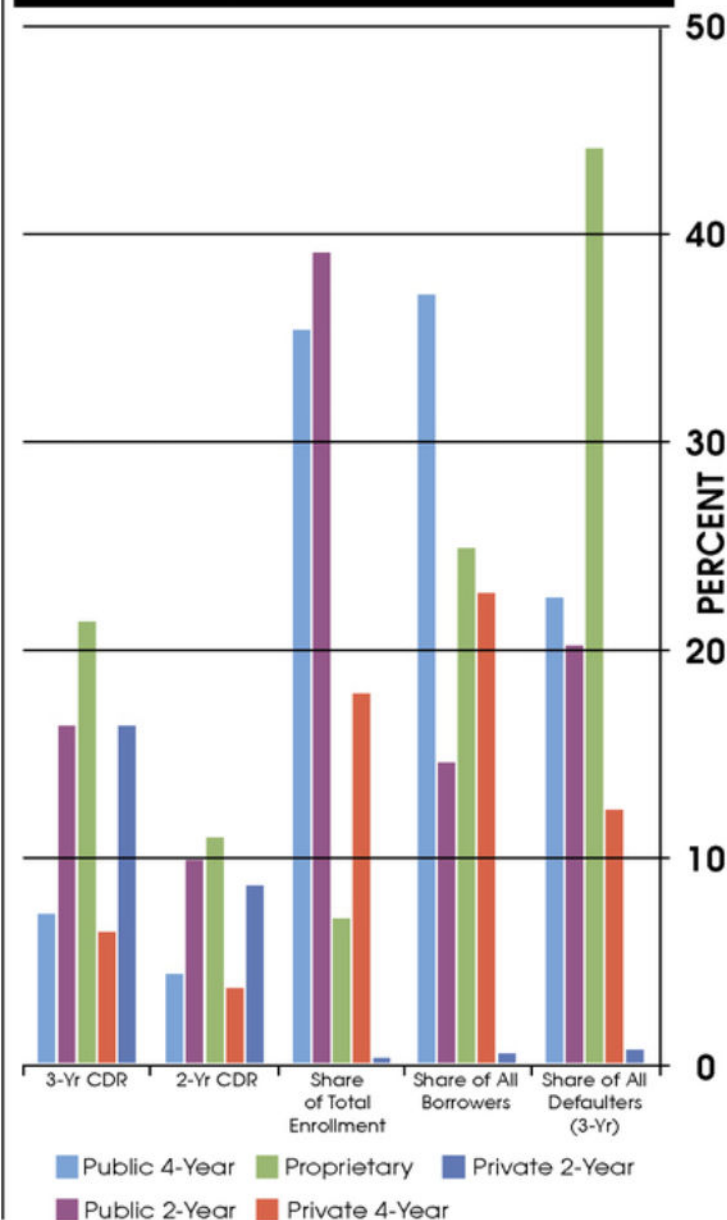
#### Upcoming Policy Changes and Trial Data

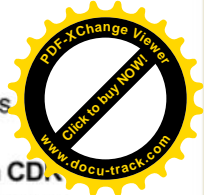
Currently, two-year cohort default rates determine a loss of eligibility for federal financial aid programs if a school's CDR is greater than 40 percent in a given year, or exceeds 25 percent for three consecutive years. If an institution has a CDR above 25 percent in a single year, then it is placed on provisional status, meaning that it needs to clean up its act. Beginning in 2012, three-year CDRs will go into effect, with the 40 percent single year rule remaining intact. However, a CDR will have to exceed 30 percent for three consecutive years to lose Title IV eligibility, with single year provisional status kicking in with a showing of 30 percent. In anticipation of the upcoming regulatory change, the Department of Education (ED) released trial data last December on three-year student loan cohort defaults for the 2005-2007 fiscal years. This data will not be used to determine official eligibility for federal aid programs, but are intended to provide institutions with a perspective of where they would stand if the changes were to be implemented now.

When the data was aggregated, it revealed that the 2007 three-year CDR among proprietary institutions was 21.2 percent, much higher than the rates reported for the other sectors: 16.2 percent for both public and private not-for-profit, two-year schools, and 7.1 and 6.3 percent for public and private not-for-profit (NFP) four-year schools, respectively. One policy analyst responded to the CDR

figures by stating that "for-profit schools enroll substantially more borrowers and defaulters than their share of enrollment would suggest." The proprietary sector's share of borrowers to share of enrollment ratio is 3.52, far exceeding the other sectors whose ratios range from 0.37 at public two-year to 1.85 at private two-year institutions; whereas its share of defaulters to share of borrowers' ratio is 1.77, exceeding that of the other sectors whose ratios range from 0.54 at private four-year NFP to 1.38 at public two-year institutions. These figures are illustrated in Figure 1, but they do not tell the entire story of CDRs because the proprietary sector also enrolls a disproportionately higher share of students with demographic characteristics that make them more likely to default.

**Figure 1: 3-Yr and 2-Yr CDRs, Share of Enrollment, Borrowers and Defaulters, by Sector, 2007**





## What Leads to High Cohort Default Rates?

A August 2009 report from the General Accountability Office (GAO) indicated that high borrower default rates are closely linked to low family income, parental education, student age and loan amounts. Moreover, statistical models computed by BridgeSpan Financial indicate that the most important factor in explaining the variation in CDRs is mainly “the degree to which an institution collected and reported information about its student body.” This variable was found to account for more than one-third of the variation in CDRs. Other important explanatory variables (in order of influence) included the percentage of students receiving a Pell Grant, degree levels offered and institutional factors such as profit status.

Overall, the students attracted to proprietary institutions have much lower family incomes, parents with lower levels of education, tend to be older, and take out more debt than their public and private NFP counterparts – making them more likely to default on their student loans regardless of the type of institution they attend. According to the GAO report, the annual median family income of proprietary education students in 2004 was \$24,300, which pales in comparison to the \$40,400 and \$49,200 median family incomes of public and private NFP sector students, respectively. Only 37 percent of proprietary sector students had parents with an Associate degree or

*“Proprietary education’s high CDR does not reflect the fact that many proprietary institutions are performing just as well as, if not better than, highly regarded public and private NFP institutions, nor does it reflect that the sector enrolls a relatively high proportion of students with characteristics that make them more likely to default.”*

higher in 2004, whereas the rates for public and private NFP were 52 and 61 percent, respectively. The majority of students attending propriety schools (56 percent) were above age 25, whereas only 35 and 38 percent of public and private NFP students were older than 25. The College Board reported that the median loan debt of borrowers at bachelor degree granting proprietary institutions was \$32,653 in 2007-08, whereas similar public and private not-for-profit students had lower debt levels of \$17,700 and \$22,375, respectively.

As I noted in an article for the November/December issue of this magazine, proprietary schools enroll a much higher percentage of federal grant recipients (as well as minority students) than the other sectors. Because the proprietary sector attracts a greater share of the most at-risk students, it is also more closely scrutinized than traditional institutions that enroll mostly low-risk students

who come from more affluent and educated families.

## Rebutting Criticism of the Proprietary Sector’s High CDR

Some critics use the low-income and working-class status of the proprietary sector students to question whether such high-risk students should enroll in proprietary schools and risk accumulating a heap of debt, or if they might be better served enrolling in less expensive public institutions. Such criticisms neglect the possibility that proprietary schools often offer services sought by these students such as flexible scheduling, career-focused training and a shorter time to degree. It also incorrectly assumes that such students would experience a better outcome if they attended a public institution. The empirical evidence mentioned above does not support this claim.

Other critics contend that the open admission policies of many proprietary schools have resulted in unqualified students enrolling who get little benefit from the education, leading to onerous debt loads and high default rates. This argument is not applicable to the entire sector, nor is it restricted to it. Many graduates of proprietary schools do not default on their student loans (nearly four out of five) and do in fact go on to earn a decent standard of living. This hardly suggests an epidemic failure on the part of proprietary institutions. The high CDRs of low-cost community colleges, which attract a similar student demographic as proprietary schools and

generally also have open admission policies, suggests that the outcomes do not improve much by sector. In fact, completion rates at community colleges are significantly lower than every other sector. And because unqualified students are not likely to gain admission to a four-year school, and would likely experience a similar outcome if they did, they are limited in choice to schools with an open admissions policy. By suggesting that such students should be barred from enrolling in an open admissions institution is essentially denying the right of an individual (assuming that he/she willingly enrolls and is aware of the risks involved) to make a decision that may improve his/her career and life prospects.

## Books Shouldn’t be Judged by their Cover

The empirical evidence suggests that books should not be judged by their cover – in this case the 21.2 percent three-year sector CDR. There are many exemplary



examples of proprietary institutions performing at or above par with respect to their public and private NFP counterparts. In fact, 373 proprietary institutions had a three-year CDR less than or equal to the overall industry rate of 11.8 percent, with 198 of these having a CDR less than the public four-year sector rate of 7.1 percent. There are also 49 private NFP and 38 public four-year institutions with a three-year CDR above the proprietary sector aggregated rate of 21.2 percent.

In addition, several proprietary institutions with large enrollments, such as Grand Canyon University, Walden University and American Public University, sport around a 3 percent CDR, and Capella University exhibits a 5.5 percent CDR. All four of these institutions have a CDR equal to or less than the highly regarded Ohio State University – a public institution. With nearly 400,000 students, the primarily online University of Phoenix has a CDR comparable to the largest public institution in the nation – Miami Dade College. This evidence hardly suggests that high CDRs are intrinsic to the proprietary sector.

**Act Before Acted Upon**

Proprietary education’s high CDR does not reflect the fact that many proprietary institutions are performing just as well as, if not better than, highly regarded public and private NFP institutions, nor does it reflect that the sector enrolls a relatively high proportion of students with characteristics that make them more likely to default. However, the fact that more than one in five proprietary education students defaulted on their loans within three years does not rest well with the American public or policy makers. Proprietary institutions should take the initiative to lead the way towards improving their educational value so that students, especially those who are most likely to default on loans, can afford to undertake career training opportunities that will provide them with the skills needed to earn a decent standard of living and make a contribution to society. Continued poor performance in this important policy metric will result in some schools losing eligibility for federal financial aid, but it may also lead to policy makers being pressured to impose stricter regulations aimed to protect consumers that may arrive with unintended consequences such as price controls or reduced access for underqualified students. In other words, the proprietary education sector needs to act before it is acted upon. ■



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