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Health, Education and Human Services Division

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April 17, 1998

The Honorable Christopher Shays
Chairman, Subcommittee on Human Resources
Committee on Government Reform and Oversight
House of Representatives

Subject: Student Loans: Effect of Including Certain Types of Loans in Calculating Schools' Default Rates

Dear Mr. Chairman:

This letter responds to your request for information about the formula specified in the Higher Education Act of 1965, as amended, for calculating schools' student loan cohort default rates. Specifically, you requested information on the effect on schools' default rates of including loans in deferment (for which payments have been temporarily postponed) or forbearance (for which payments have been temporarily postponed or reduced or for which the repayment period has been extended) in the denominator of the formula. You are concerned that the requirement in the act may lower the default rates the Department of Education uses to determine schools' eligibility to participate in the two major federal student loan programs.[1]

To develop this information, we reviewed relevant legislation and Department of Education regulations and publications on calculating the cohort default rate and on the basis for granting deferment and forbearance for student loans. We also discussed these issues with Education officials.

Colleges, universities, and proprietary schools participating in the two major federal student loan programs authorized by the Higher Education Act of 1965,

[1]The Federal Family Education Loan Program (FFELP) provides loans from private lenders insured against borrower default by state or nonprofit guaranty agencies and reinsured by the federal government; the William D. Ford Federal Direct Loan Program (FDLP) provides loans from the government through students' schools.

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as amended, must have a cohort default rate below certain thresholds to maintain their eligibility to participate in the loan programs. The cohort default rate is a percentage that results from dividing the number of students who enter repayment status in a given fiscal year and default at or before the end of the next fiscal year by the number of students who enter repayment status in that given fiscal year.[2] For example, if 100 students from a school were scheduled to begin repaying their loans in fiscal year 1995 and 25 defaulted on their loans by the end of fiscal year 1996, the school's fiscal year 1995 cohort default rate would be 25 percent.

Each year, the Department of Education assesses a school's eligibility on the basis of its three most recent available cohort default rates. In fiscal year 1998, eligibility was based on cohort default rates for fiscal years 1993, 1994, and 1995. A school remains eligible if its cohort default rate is below the statutory threshold, currently 25 percent, in at least 1 of the latest 3 consecutive fiscal years. A school loses eligibility if its default rate equals or exceeds the default threshold in all 3 years. Historically Black Colleges and Universities, tribally controlled community colleges, and Navajo community colleges are exempt from this sanction until July 1, 1998.

In addition, under Department regulations, schools with a 1-year default rate above 40 percent may have their eligibility for all title IV student financial aid programs (not just federal loan programs) limited, suspended, or terminated. This sanction applies to all schools. The Department of Education's FY 1995 Official Cohort Default Rate Guide, published in November 1997, thoroughly discusses cohort default rates. Appendix E1 of the Guide cites the portions of the Higher Education Act of 1965, as amended, that address cohort default rates.

Students may delay repaying their loans by obtaining a deferment or forbearance on their loan after entering repayment status. In the case of deferments, borrowers are not charged interest during the deferment of subsidized loans but are charged interest during deferment of unsubsidized loans. Borrowers may pay the interest monthly or the interest may be capitalized. Borrowers may defer payments if, for example, they are (1) pursuing at least half-time study at a school eligible to participate in federal

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[2]If fewer than 30 borrowers at a school entered repayment status in a given year, the cohort default rate is the percentage of borrowers who entered repayment status in the 3 most recent years but who defaulted by the end of the fiscal year after entering repayment status.

student financial aid programs, (2) conscientiously seeking but unable to find full-time employment (for up to 3 years), or (3) experiencing economic hardship (for up to 3 years). Forbearance involves temporarily ceasing payments, extending the time for making payments, or temporarily accepting smaller payments than previously scheduled. The borrower may choose the form of forbearance. If interest payments are forborne, they are capitalized. To obtain forbearance, the borrower must request it and provide sufficient documentation to support the request. The borrower may receive forbearance if, for example, the borrower has poor health and cannot make scheduled payments or the Secretary of Education has authorized forbearance due to a national military mobilization or other local or national emergency.

Because borrowers with loans in deferment or in one type of forbearance (that which permits borrowers to temporarily stop payments) do not have to make payments, these loans do not, by definition, go into default and thus are excluded from the numerator (loans in default) of the cohort default rate calculation. The Department, however, includes all loans in deferment or forbearance in the denominator (loans in repayment) when calculating schools' cohort default rates. The greater the number of loans in deferment or forbearance in the denominator, the more a school's cohort default rate is reduced below what it would be if those loans were excluded from the denominator. For example, if 10 of 100 borrowers entering repayment status in a given year from a school were in deferment or in forbearance (the type requiring no payments) and 20 of the 100 borrowers entering repayment status defaulted by the end of the next fiscal year, the cohort default rate would be 20 percent (20 borrowers/100 borrowers). In contrast, if these loans in deferment or forbearance were excluded from the denominator, the school's default rate would be 22.2 percent (20 borrowers/90 borrowers).

Data on the number of FFELP and FDLP loans in repayment that are in deferment or forbearance were not readily available from the Department. However, we developed similar data for FDLP borrowers for a recent report.[3] Of the 580,235 FDLP borrowers in repayment status as of December 31, 1996, 28,534 were in deferment and 20,206 were in forbearance. Thus, 48,740 borrowers or 8.4 percent of all FDLP borrowers in repayment status were in deferment or forbearance. If loans in deferment and those in forbearance that do not require borrowers to make payments had been excluded from the denominator in calculating schools' FDLP cohort default rates, those cohort

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[3]Direct Student Loans: Analyses of Borrowers' Use of the Income Contingent Repayment Option (GAO/HEHS-97-155, Aug. 21, 1997).

default rates would have been somewhat higher. The amount of the increase in a school's cohort default rate would depend on what portion of each school's loans in repayment were in deferment or in the type of forbearance not requiring borrowers to make payments.

AGENCY COMMENTS

The Department of Education reviewed a draft of this correspondence. It said our description of the Department's calculations of schools' cohort default rates is accurate and had no other comments.

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We are sending copies of this correspondence to appropriate congressional committees, the Secretary of Education, and other interested parties. If you or your staff have any questions or wish to discuss this material further, please call me or Jay Eglin, Assistant Director, at (202) 512-7014. Major contributors to this letter are Susie Anschell and Charles M. Novak.

Sincerely yours,

Carlotta Joyner

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