Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs

FINAL AUDIT REPORT

ED-OIG/A03-C0017
DECEMBER 2003

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U.S. Department of Education
Office of Inspector General
Philadelphia, Pennsylvania

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Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinion of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

DEC 22 2003

Memorandum

TO: Sally Stroup
Assistant Secretary for Postsecondary Education
Lead Action Official

Theresa S. Shaw
Chief Operating Officer
Federal Student Aid

FROM: Helen Lew Helen Lew
Assistant Inspector General for Audit Services

SUBJECT: Final Audit Report
"Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs."
Control Number ED-OIG/A03-C0017

Attached is the subject final audit report that covers the results of our review of default rates for the 1996 through 1999 cohorts. An electronic copy has been provided to your Audit Liaison Officers. We received your comments, in which you did not disagree with our findings but raised concerns about our recommendations.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your offices will be monitored and tracked through the Department's automated audit tracking system. ED policy requires that you develop a proposed Corrective Action Plan (CAP) in the automated system within 60 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the number of audits unresolved. In addition, any reports unresolved after 180 days from the date of issuance will be shown as overdue in our reports to Congress.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given us during this review. If you have any questions, please call Bernard Tadley, Regional Inspector General for Audit, at (215) 656-6279.

Attachment

AUDIT TO DETERMINE IF COHORT DEFAULT RATES PROVIDE SUFFICIENT INFORMATION ON DEFAULTS IN THE TITLE IV LOAN PROGRAMS

ED-OIG/A03-C0017

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EXECUTIVE SUMMARY

The objective of our audit was to determine if cohort default rates, as calculated under the Higher Education Act of 1965, as amended (HEA), provide sufficient information on defaults in the Title IV loan programs. Cohort default rates provide sufficient information to the Department of Education (Department), Congress, and other decision makers if they provide comprehensive, complete, and accurate information that reflects general trends in defaults.

To accomplish our objective, we gathered and analyzed data about borrowers in the 1996 through 1999 cohorts: we identified borrowers in each cohort who defaulted in the 90-day and one-year periods immediately following the end of the two-year cohort period,[1] and we identified borrowers in each cohort whose loans were in a deferment or forbearance on the last day of the two-year cohort period.

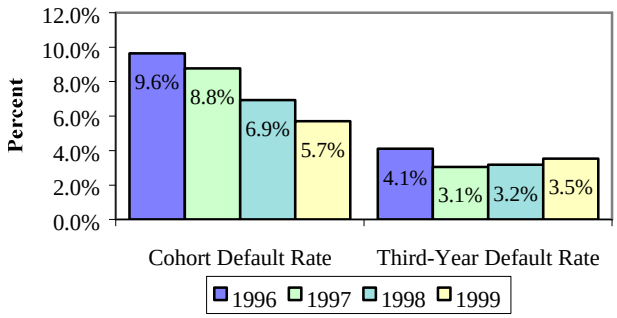
Although cohort default rates provide the information required under the HEA, they do not appear to provide decision-makers with sufficient information on defaults in the Title IV loan programs. Specifically, we identified two findings:

1. *Cohort default rates do not appear to reflect general trends in defaults in the year following the two-year cohort period.*

   - The Higher Education Amendments of 1998 (1998 Amendments) changed the definition of default for loans for which the first day of delinquency occurred on or after October 7, 1998, from a 180-day delinquency to a 270-day delinquency. To examine this change's impact, we adjusted the 1998 and 1999 cohort default rates to account for the 90 days added to the delinquency period. We found that the definition's change may have resulted in the 1998 and 1999 cohort default rates' being materially lower than they would have been, if they had been calculated using the previous definition of default.

   - Default trends during the third year (the fiscal year immediately following the two-year cohort period) were not always similar to trends of cohort default rates. As Graph S-1 shows, the 1997 through 1999 cohort default rates decline each year, but the third-year rates for the same cohorts increase.

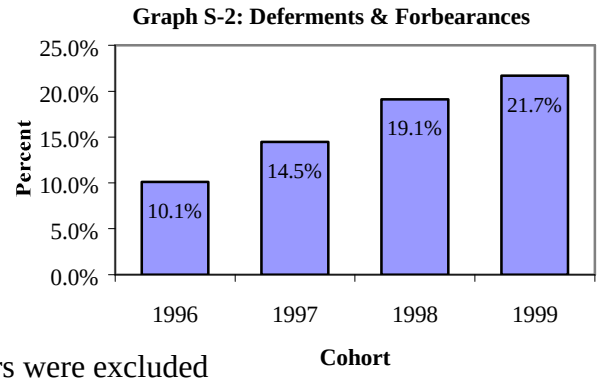
Graph S-1: Third Year Rates



[1] In this report, the "two-year cohort period" is the fiscal year in which the cohort's borrowers entered repayment on their loans and the following fiscal year. For example, the 1998 cohort default rate was calculated based on the number of borrowers who entered repayment on their loans in FY 1998 and who defaulted during the two-year cohort period (FYs 1998 and 1999).

- The distribution of defaults over a three-year cohort period (the two-year cohort period combined with the following one-year period) changed by a material amount from the 1996 to 1999 cohorts: 70.1 percent of the cohort borrowers who defaulted during the 1996 three-year cohort period defaulted in the first two years, while only 61.6 percent of the cohort borrowers who defaulted during the 1999 three-year cohort period defaulted in the first two years.

2. *Borrowers in deferment and forbearance lower schools' cohort default rates*. In 1999, the General Accounting Office (GAO) found that the percentage of borrowers with loans in deferment or forbearance more than doubled between 1993 and 1996, from 5.2 percent to 11.3 percent.[2] Though our numbers were different than GAO's, we identified the same trend: the percentage of borrowers with loans in deferment or forbearance more than doubled between the 1996 and 1999 cohorts, from 10.1 percent to 21.7 percent. (See Graph S-2.) If these borrowers were excluded entirely from the 1996 through 1999 cohort default rate calculations—because the borrowers were not making payments during the cohort default period, and could not default—the effect would be a material increase in cohort default rates for those years.



Changes to the definition of default and repayment practices have materially reduced schools' cohort default rates, while threshold percentages for schools' ineligibility have remained unchanged since 1994. For example, because the change in the definition of default increased the number of days it takes for a borrower to default, some borrowers may not be included as defaulters in the cohort default rate calculation, even though they never make a payment on their loans and default at the first opportunity.

We recommend that the Assistant Secretary for Postsecondary Education and the Chief Operating Officer for Federal Student Aid support amendments to the HEA, that would

- *Include* defaults in the cohort default rate calculation that have been excluded by the 1998 Amendments' change to the definition of default, and
- *Exclude* borrowers who are in deferment or forbearance status from cohort default rate calculations until the deferment and forbearance ends and they are subject to a default risk on their loans.

We also recommend that the Department calculate and publish a life-of-cohort default rate for each cohort, to better identify the trends in cohorts' defaults after the two-year cohort period has ended.

[2] *Student Loans: Default Rates Need to Be Computed More Appropriately*, GAO/HEHS-99-135 (July 1999).

A draft of this report was provided to the Office of Postsecondary Education (OPE) and Federal Student Aid (FSA) for review and comment. In its comments on the draft report, developed with FSA, OPE did not disagree with our findings, but noted concerns with our recommendations. We have incorporated OPE's comments, where appropriate, into the report and provide their full response in Appendix C.

BACKGROUND

Loan Programs under Title IV of the HEA

The Department administers the William D. Ford Federal Direct Loan (Direct Loan) Program and Federal Family Education Loan Program (FFELP) to help students finance the costs of higher education. The Direct Loan Program and FFELP are authorized under Title IV of the HEA. The Department makes Direct Loan Program loans directly to borrowers and guarantees all or a portion of FFELP loans made by participating lending institutions for students' attendance at eligible institutions of higher education. Eligible institutions of higher education include public and private two- and four-year schools, graduate schools, and vocational training schools. Students and their parents may be eligible to receive loans. Student borrowers who demonstrate financial need may receive federal interest subsidies on their loans.

The federal government makes Direct Loan Program loans directly to students and parents, through participating schools. Direct Loans are originated and serviced through contracts with private vendors. Under the FFELP, over 4,000 financial institutions make loans to students and parents. FFELP loans are guaranteed by the federal government against default, with 36 state or non-profit guaranty agencies acting as intermediaries in administering the loan guarantees.

Both the Direct Loan Program and FFELP offer the following types of loans:

- Subsidized loans to students. Subsidized loans are based upon students' financial need. The federal government subsidizes the interest accruing on the loan before students begin repayment or while they are in deferment.
- Unsubsidized loans to students. Unsubsidized loans are not based upon financial need. Interest on an unsubsidized loan accrues from the time the loan is disbursed until it is paid in full.
- PLUS loans to parents, for children who are dependent undergraduate students.
- Consolidation loans, to allow student or parent borrowers to combine several types of federal loans into one loan.

Implementing Cohort Default Rates

In 1987, the Department was concerned that increasing student loan default costs were undermining public confidence in the loan programs. A study found about 950 schools had fiscal year (FY) 1985 default rates greater than 40 percent. The Department had taken actions to control loan defaults by implementing default prevention and collection activities, including use of private collection agencies, use of salary offsets, notifying credit bureaus, use of IRS tax refund offsets, and increasing lender and guaranty agency due diligence requirements.

The Department also sought statutory changes to broaden loan consolidations and to allow the use of the National Student Loan Data System (NSLDS) to verify borrower eligibility. To further control loan defaults, the Department issued regulations to hold schools responsible for keeping loan program default rates of student borrowers who attend their institutions below a specified threshold for the first two years of repayment. A school's default rate that exceeds the threshold indicates that the school may not have adequate institutional capability to administer the loan programs and may pose an unreasonable risk of loss to taxpayers. Congress added sanctions based on cohort default rates to the HEA in 1990.

Uses of Cohort Default Rates

Cohort default rates help save taxpayers money because they are an indicator of a school's ability to properly administer the Title IV programs, and because high rates affect the school's eligibility under the HEA and the regulations. Cohort default rates provide an incentive to schools to work with their borrowers to reduce defaults.

Under Sections 401(j)(1) and 435(a) of the HEA and 34 C.F.R. § 668.187(a)(2), if a school's three most recent cohort default rates are 25 percent or greater, that school loses its eligibility to participate in the FFELP, Direct Loan, and Federal Pell Grant programs for the remainder of the current FY and for the two following FYs. Under 34 C.F.R. § 668.187(a)(1), if a school's most recent cohort default rate is greater than 40 percent, the school loses its eligibility to participate in the FFELP and Direct Loan Program for the remainder of the current FY and for the two following FYs.[3]

Schools with low cohort default rates are eligible for an exemption from certain requirements. If a school's most recent cohort default rate is less than 5 percent, the school may deliver loan proceeds in a single installment to a student studying abroad. Until September 30, 2002, if a school's three most recent cohort default rates were less than 10 percent, the school was able to deliver loan proceeds in a single installment or chose not to delay the delivery of the first installment of a loan for first-time, first-year borrowers. Neither the Department's nor Federal Student Aid's current Performance Plans include cohort default rates as a performance indicator or measure.

The Department uses a default rate as a partial basis for its estimate of loan program subsidy rates. Loan program subsidy rates are the federal portion of non-administrative costs (principally interest subsidies and defaults) associated with each borrowed dollar, and are used to develop loan program cost estimates. The default rates used by the Department to develop loan program cost estimates, provided in Appendix A to this report, represent projected defaults over the life of the loan cohort and are not the same as cohort default rates calculated under the HEA.

[3] Unless otherwise specified, all regulatory citations are to the July 1, 2001, volume.

Calculating Cohort Default Rates

Cohort default rates are calculated using formulas established in Section 435(m) of the HEA and promulgated in regulations at 34 C.F.R. Part 668, Subpart M. If a school has 30 or more borrowers entering repayment, the cohort default rate is calculated as follows:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and who default by the end of the following FY.}}{\text{The number of borrowers who enter repayment in the cohort FY.}}$$

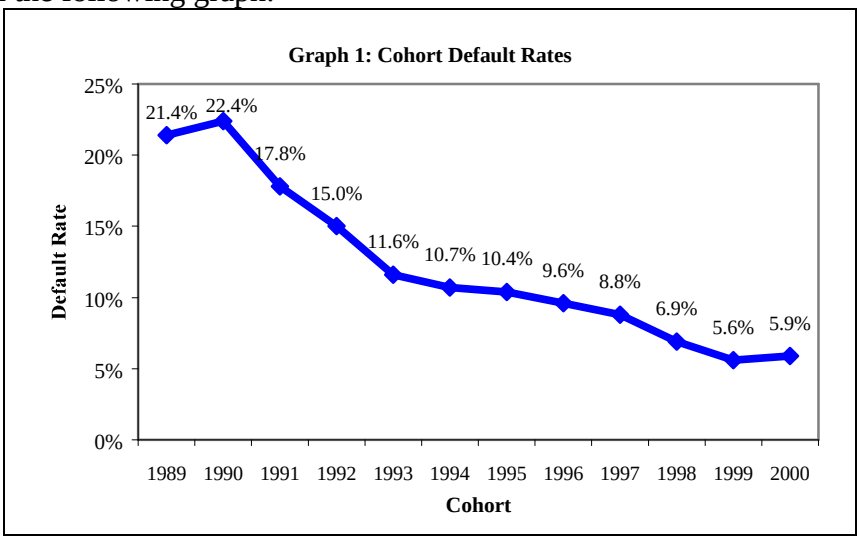
If a school has 29 or fewer borrowers entering repayment, the cohort default rate is calculated as follows:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and the two preceding FYs and who default by the end of the FY immediately following the cohort FY in which they entered repayment.}}{\text{The number of borrowers who enter repayment in the cohort FY and the two preceding cohort FYs.}}$$

Students with subsidized and unsubsidized FFELP and Direct Loan Program loans and Federal Supplemental Loans for Students (which have not been made since July 1, 1994) are included in the cohort default rate calculation. Borrowers are not included in the cohort default rate calculation on the basis of PLUS loans or Federal Insured Student Loans. Consolidation loan borrowers are included only on the basis of the loans that were repaid by the Consolidation loan.

History of Defaults

Cohort default rates have declined significantly since the late 1980's and early 1990's, as exhibited in the following graph:



Source: U.S. Department of Education, Federal Student Aid, September 2002.

Despite this decline in cohort default rates, the total dollar amount of defaults outstanding continued to increase because the total dollar amount of loans outstanding continued to increase.[4] During the period from the end of FY 1995 to the end of FY 1999 the amount of loans in default grew at a slower rate than the amount of loans outstanding. The amount of loans in default increased 26 percent, from approximately $18 billion at the end of FY 1995 to approximately $22.6 billion at the end of FY 1999. During the same period, the amount of loans outstanding increased 76 percent, from approximately $114 billion at the end of FY 1995 to approximately $201 billion at the end of FY 1999. The total dollar amount of loans in default and loans outstanding is provided in the following table:

Table 1					
Cumulative Amount of Defaulted Loans Held by the Department and Guaranty Agencies (in millions of dollars)					
Fiscal Year Ended September 30th	**1995**	**1996**	**1997**	**1998**	**1999**
Subsidized	$13,678	$12,290	$13,610	$14,472	$15,376
Unsubsidized	$56	$100	$376	$782	$1,307
PLUS	$1,118	$1,063	$1,298	$1,376	$1,070
Supplemental Loans for Students	$3,096	$3,151	$3,181	$3,125	$2,985
Consolidation	$29	$133	$383	$941	$1,898
Total Defaulted Loans*	**$17,976**	**$16,738**	**$18,847**	**$20,697**	**$22,637**
Cumulative Amount of Loans Outstanding and in Default (in millions of dollars)					
Fiscal Year Ended September 30th	**1995**	**1996**	**1997**	**1998**	**1999**
Subsidized	$75,878	$80,798	$89,251	$97,185	$102,554
Unsubsidized	$10,040	$17,374	$26,084	$35,297	$43,403
PLUS	$6,481	$7,607	$9,144	$10,635	$11,461
Supplemental Loans for Students	$10,477	$9,292	$8,303	$7,474	$6,537
Consolidation	$11,176	$16,039	$20,212	$25,466	$37,055
Total Outstanding Loans*	**$114,053**	**$131,110**	**$152,993**	**$176,058**	**$201,010**
*Amounts may not add due to rounding. *Source: U.S. Department of Education, Office of the Under Secretary, Budget Service*					

Definition of Default

The 1998 Amendments amended Section 435(l) of the HEA to change the definition of default for loans for which the first day of delinquency occurred on or after October 7, 1998, from a 180-day delinquency to a 270-day delinquency.

[4] In OPE's response to the report, OPE states that, in recent years (i.e., FYs 2000 and 2001), the outstanding defaulted portfolio is decreasing because collections are outpacing the amount of defaults. The response includes a graph, comparing non-defaulted loans outstanding to defaulted loans outstanding, which OPE believes provides a clearer picture of the defaulted portfolio relative to the total loans outstanding.

For purposes of calculating cohort default rates, a FFELP borrower is generally considered to be in default if an insurance claim is paid on the borrower's loan during the two-year cohort period.[5] For Direct Loans, specific timeframes are included in 34 C.F.R. § 668.183 to determine if a Direct Loan is considered to be in default for cohort default rate purposes. Since there is usually a 90-day period between the date a FFELP loan defaults and the date the insurance claim is paid to the lender, a corresponding 90-day period is included in the timeframe for Direct Loan defaults.

As a result of changes in the definition of default, the timeframe for considering a borrower in default for cohort default rate purposes on a FFELP loan increased from about 270 days (180 days delinquency plus about 90 days to pay the claim) to about 360 days (270 days delinquency plus about 90 days to pay the claim), and the timeframe for considering a borrower to be in default for cohort default rate purposes on a Direct Loan increased from 270 days to 360 days.

The change in the definition of default impacted cohort default rates in a number of ways. For example, the change in the definition of default may enable a borrower who never makes a payment on his or her loan to be excluded from the cohort default rate calculation:

- Under the previous, 180-day definition of default, it would take about 330 days for a borrower to be considered in default and included in the numerator of a cohort default rate calculation. (60 days until the first scheduled payment is due[6] + 270 days to default = 330 days.) Since 330 days is *less* than a year, it may have been possible for the last borrower in the cohort who makes no payments to default before the end of the following fiscal year.

- Under the current, 270-day definition of default, it would take about 420 days for a borrower to be considered in default and included in the numerator of a cohort default rate calculation (60 days until the first scheduled payment is due + 360 days to default = 420 days.) Since 420 days is *more* than a year, it may not be possible for some of the last borrowers in the cohort who make no payments to default before the end of the following fiscal year.

[5] We previously reported and recommended that the actual default date be captured and used to calculate cohort default rates. The previous report, *Change in the Computation of Cohort Default Rates Would Make Rates More Accurate*, March 2000 (ED-OIG/A06-7006), is available on the internet at http://www.ed.gov/about/offices/list/oig/areports2000.html. The recommendations from the report have not been implemented, so we used the claims-paid date for all calculations in this report.

[6] In general, the first payment on a FFELP or Direct Loan is due approximately 60 days from the date the borrower enters repayment. The timeframe for making a first payment on a FFELP loan changed on July 1, 2003, from 45 days to 60 days after the borrower enters repayment. (34 C.F.R § 682.209(a)(3)(ii) (2003))

AUDIT RESULTS

The objective of our audit was to determine if cohort default rates, as calculated under the HEA, provide sufficient information on defaults in the Title IV loan programs. Cohort default rates provide sufficient information to the Department, Congress, and other decision makers if they provide comprehensive, complete, and accurate information that reflects general trends in defaults.

Our audit covered the 1996 through 1999 two-year cohort periods and the FY following each two-year cohort period. Although cohort default rates provide the information required under the HEA, they do not appear to provide decision makers with sufficient information on defaults in the Title IV loan programs. Changes to the definition of default and repayment practices have materially reduced schools' cohort default rates, while threshold percentages for schools' ineligibility have remained unchanged since 1994.

Without information that reflects the general trends in defaults, schools may continue to participate in Title IV programs, even though a significant percentage of the schools' students may default on their loans. Defaulted student loans cost taxpayer money. Default rates that provide improved information on student loan defaults may allow the Department to terminate or suspend marginal schools' eligibility to participate in Title IV programs, thereby reducing the risk of loss to taxpayer funds.

FINDING NO. 1 - COHORT DEFAULT RATES DO NOT APPEAR TO REFLECT GENERAL TRENDS IN DEFAULTS IN YEAR FOLLOWING TWO-YEAR COHORT PERIOD

As described in this section, we used data we obtained for defaults that occurred after the two-year cohort period ended to calculate other types of default rates: adjusted default rates, third-year default rates, and three-year default rates. Based on our analysis of these other types of default rates, cohort default rates calculated under the HEA do not appear to reflect general trends in defaults in the year following the two-year cohort period.

As a result, cohort default rates do not appear to provide decision makers with sufficient information on defaults in the Title IV loan programs. Cohort default rates do not capture information on defaults beyond the two-year cohort period, because the HEA specifies that cohort default rates only include defaults that occur during the FY in which the borrower enters repayment and in the following FY. Without information that reflects the general trend in defaults, schools may continue to participate in Title IV programs even though a significant percentage of their students may default. Defaulted student loans cost taxpayers money.

Adjusted Default Rates

As noted in the Background section, the 1998 Amendments amended Section 435(l) of the HEA to change the definition of default for loans for which the first day of delinquency occurred on or after October 7, 1998, from a 180-day delinquency to a 270-day delinquency.

If other factors affecting the timing of borrower default remained constant, the change in the definition of default affected the 1998 and later cohort default rate calculations by removing defaults that would have been recognized during the last 90 days of the two-year cohort period under the previous, 180-day definition: some delinquent borrowers who would have been counted as defaulters under the prior definition are no longer counted.

- Under the 180-day definition, a borrower would have to become delinquent by about January 4 of the second fiscal year in the two-year cohort period in order to be counted as a defaulter (January 4 + 180 days to default + 90 days for the FFELP claim or Direct Loan equivalent = September 30).

- Under the 270-day definition, a borrower would have to become delinquent 90 days earlier, on about October 6 of the second fiscal year, in order to be counted as a defaulter (October 6 + 270 days to default + 90 days for the FFELP claim or Direct Loan equivalent = September 30).

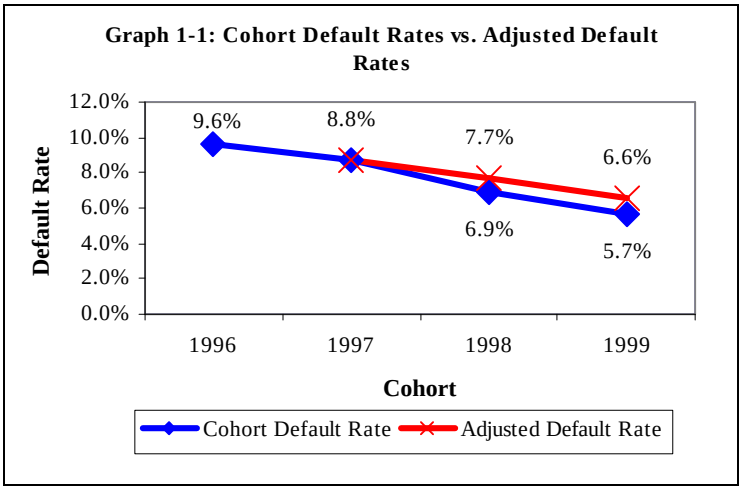
To determine the impact of the change in the definition of default on cohort default rates, we identified borrowers who defaulted in the 90-day period following the two-year cohort periods, and we included those defaulters when calculating adjusted default rates for the 1998 and 1999 cohorts. Including defaults from this 90-day period should account for the 90 days that were added by the 1998 Amendments to the delinquency period that results in a default (i.e., from 180 days to 270 days).

If other factors affecting the timing of borrowers' defaults remained constant, these adjusted default rates should permit year-to-year comparisons of data from before and after the change in the definition of default. Other factors may have also affected the timing of borrower default: the amount of time between the date the borrower enters repayment and the date of his or her first scheduled payment, the borrower's payment history, the amount of time it takes for a lender to submit a default claim, the amount of time it takes for a guaranty agency to process a default claim, and other factors.

We calculated adjusted default rates for the 1998 and 1999 cohorts as follows:

$$\frac{\text{Number of borrowers who enter repayment in the cohort FY and who default during the two-year cohort period and 90 days following the two-year cohort period.}}{\text{Number of borrowers who enter repayment in the cohort FY.}}$$

We compare the adjusted default rates to cohort default rates in the following graph:



Since adjusted default rates should account for the change in the definition of default, the graph shows that, if other factors affecting the timing of borrowers' defaults remained constant, the change in the definition of default may have resulted in material understatements of the 1998 and 1999 cohort default rates, compared to what they would have been, had the definition remained unchanged: the 1998 adjusted default rate is 10.8 percent greater than the 1998 cohort default rate, and the 1999 adjusted default rate is 16 percent greater than the 1999 cohort default rate.

Public, private, and proprietary school types all experienced trends in their cohort default rates and adjusted default rates similar to those we describe for the overall default rates.

Third-Year Default Rates

We identified cohort borrowers who defaulted in the FY following the two-year cohort period and used this data to calculate third-year default rates. We calculated third-year default rates as follows:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and who default in the FY following the two-year cohort period.}}{\text{The number of borrowers who enter repayment in the cohort FY.}}$$

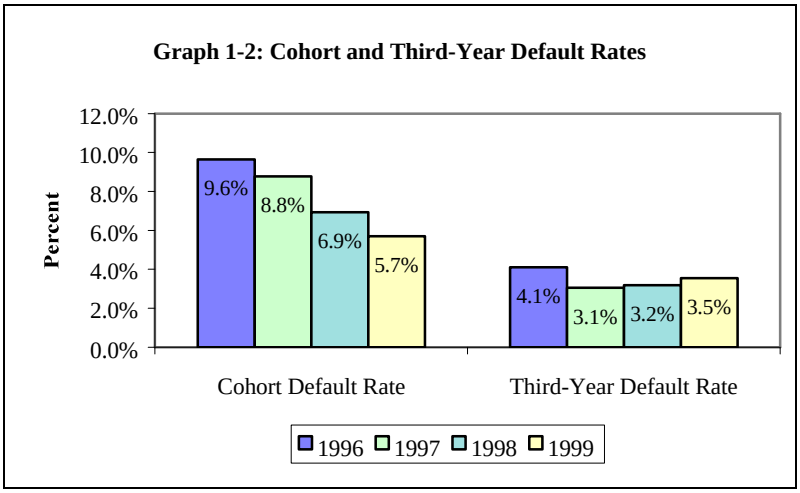
The results of our calculation are presented in the following table:[7]

Table 1-1: Third-Year Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999	Percentage Change 1997 to 1999
Overall						
Third-Year Default Rate	4.1%	3.1%	3.2%	3.5%	-13.9%	16.1%
Cohort Default Rate	9.6%	8.8%	6.9%	5.7%	-41.0%	-35.1%

Note: Amounts have been rounded to one decimal place.

A comparison of cohort default rates and third-year default rates, identified in Table 1-1, is provided in the following graph:



[7] For consistency, all default rates contained in this report have been rounded to one decimal place. In preparing cohort default rates, the Department truncates the cohort default rate at one decimal place. As a result, for some years and/or school type cohort default rates, minor differences may be noted between the cohort default rates contained in this report and those issued by the Department. For example, the truncated 1999 cohort default rate issued by the Department is 5.6%, and the rounded 1999 cohort default rate contained in this report is 5.7%.

Third-year default rates did not experience cohort default rates' consistent downward trend between the 1996 and 1999 cohorts:

- Though both the cohort and third year default rates decrease from 1996 to the 1999, the decrease of third-year default rates (from 4.1 to 3.5 percent) is significantly less than the decrease of cohort default rates (from 9.6 percent to 5.7 percent).
- Third-year default rates *increased* from the 1997 to 1999 cohorts, while cohort default rates *declined* during the same period.

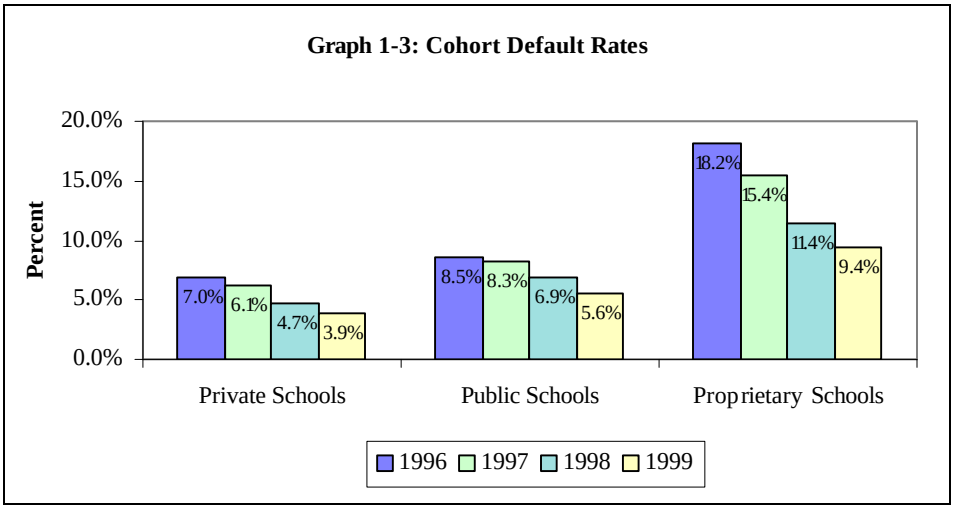
We also calculated third-year default rates for public, private, and proprietary schools. The results of our calculations are presented in the following table:

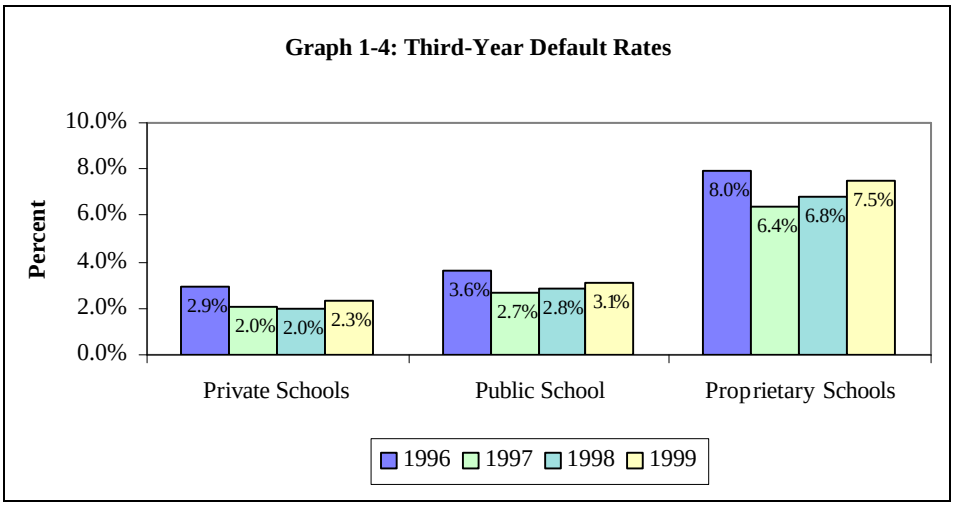
Table 1-2: School Type Third-Year Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999	Percentage Change 1997 to 1999
Public Schools						
Third-Year Default Rate	3.6%	2.7%	2.8%	3.1%	-13.4%	17.4%
Cohort Default Rate	8.5%	8.3%	6.9%	5.6%	-34.1%	-31.9%
Private Schools						
Third-Year Default Rate	2.9%	2.0%	2.0%	2.3%	-20.5%	14.3%
Cohort Default Rate	7.0%	6.1%	4.7%	3.9%	-44.3%	-36.8%
Proprietary Schools						
Third-Year Default Rate	8.0%	6.4%	6.8%	7.5%	-5.8%	17.5%
Cohort Default Rate	18.2%	15.4%	11.4%	9.4%	-48.5%	-39.2%

Note: Amounts have been rounded to one decimal place.

A comparison of cohort default rates and third-year default rates, identified in Table 1-2, is provided in Graphs 1-3 and 1-4, respectively:





A comparison of third-year default rates with cohort default rates, by school type, shows trends similar to those identified for overall default rates, in Graph 1-2.

Three-Year Default Rates

We calculated three-year default rates that included defaults that occurred during the two-year cohort period and during the FY following the two-year cohort period. We calculated three-year default rates as follows:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and who default during the two-year cohort period and the FY following the two-year cohort period.}}{\text{The number of borrowers who enter repayment in the cohort FY.}}$$

The results of our calculations are presented in the following table:

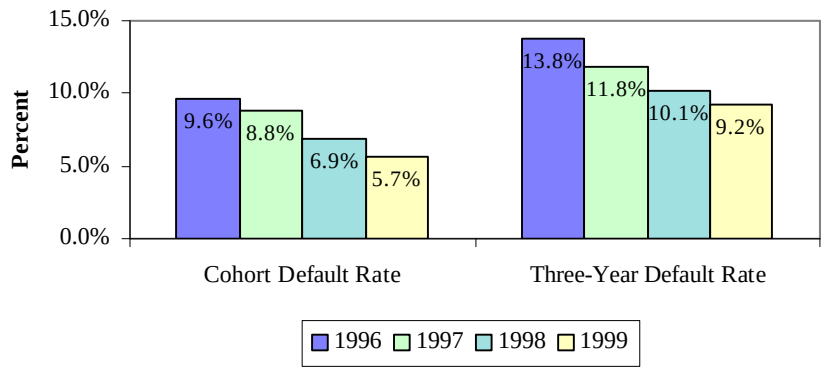
Table 1-3: Three-Year Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999
Overall					
Cohort Default Rate	9.6%	8.8%	6.9%	5.7%	-41.0%
Three-Year Default Rate	13.8%	11.8%	10.1%	9.2%	-32.8%
Percent that Three-Year Rate Exceeds Cohort Default Rate	42.6%	34.8%	46.0%	62.4%	
Percentage Composition of Three-Year Default Rates					
Cohort Default Rate	70.1%	74.2%	68.5%	61.6%	-12.2%
Third-Year Default Rates	29.9%	25.8%	31.5%	38.4%	28.6%
Three-Year Default Rate	100.0%	100.0%	100.0%	100.0%	

Note: Amounts have been rounded to one decimal place.

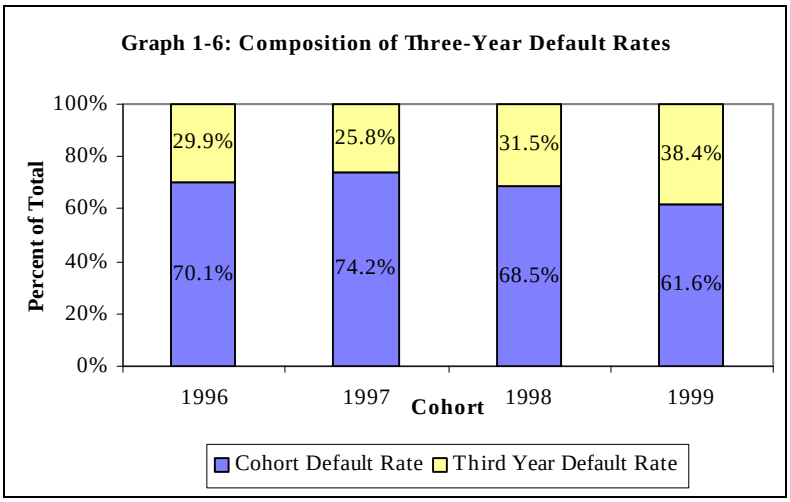
A comparison of cohort default rates and three-year default rates, identified in Table 1-3, is provided in the following graph:

Graph 1-5: Cohort and Three-Year Default Rates



Though trends for three-year default rates may appear similar to trends for cohort default rates, because both decline from 1996 to 1999, an increasing percentage of defaulters were defaulting in the third year of the three-year default rate: the 1996 three-year default rate is 42.6 percent greater than the 1996 cohort default rate, and the 1999 three-year default rate is 62.4 percent greater than the 1999 cohort default rate.

The composition of each three-year default rate, as identified in Table 1-3, is illustrated in the following graph:



An analysis of the composition of the three-year default rates, in Graph 1-6, shows that the percentage of defaults in the three-year default rate that is attributable to the two-year cohort period decreased materially from 1996 (70.1 percent) to 1999 (61.6 percent).

We also calculated three-year default rates for public, private, and proprietary schools. The results of our calculations are presented in the following table:

Table 1-4: School Type Three-Year Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999
Public Schools					
Cohort Default Rate	8.5%	8.3%	6.9%	5.6%	-34.1%
Three-Year Default Rate	12.1%	10.9%	9.7%	8.7%	-27.9%
Percentage that Three-Year Rate Exceeds Cohort Default Rate	42.0%	32.0%	41.1%	55.2%	
Percentage of Composition of Three-Year Default Rates:					
Cohort Default Rate	70.4%	75.7%	70.9%	64.4%	-8.5%
Third-Year Default Rate	29.6%	24.3%	29.1%	35.6%	20.2%
Three-Year Default Rate	100.0%	100.0%	100.0%	100.0%	
Private Schools					
Cohort Default Rate	7.0%	6.1%	4.7%	3.9%	-44.3%
Three-Year Default Rate	9.9%	8.2%	6.7%	6.2%	-37.4%
Percentage that Three-Year Rate Exceeds Cohort Default Rate	42.0%	33.1%	42.2%	59.8%	
Percentage of Composition of Three-Year Default Rates:					
Cohort Default Rate	70.5%	75.2%	70.3%	62.6%	-11.2%
Third-Year Default Rate	29.5%	24.8%	29.7%	37.4%	26.7%
Three-Year Default Rate	100.0%	100.0%	100.0%	100.0%	
Proprietary Schools					
Cohort Default Rate	18.2%	15.4%	11.4%	9.4%	-48.5%
Three-Year Default Rate	26.2%	21.8%	18.2%	16.9%	-35.5%
Percentage that Three-Year Rate Exceeds Cohort Default Rate	43.7%	41.5%	60.1%	80.1%	
Percentage of Composition of Three-Year Default Rates:					
Cohort Default Rate	69.6%	70.7%	62.5%	55.5%	-20.2%
Third-Year Default Rate	30.4%	29.3%	37.5%	44.5%	46.1%
Three-Year Default Rate	100.0%	100.0%	100.0%	100.0%	

Note: Amounts have been rounded to one decimal place.

In general, all school types included in Table 1-4 experienced the same general trends reflected in Table 1-3, for overall default rates: three-year default rates decrease each year, an increasing percentage of defaulters were defaulting in the third year, and the composition of the three year rates reflects decreased percentages of defaults attributable to the two-year cohort period.

However, two of these trends are significantly more pronounced for proprietary schools than for public or private schools. Proprietary schools show the greatest

- Increase in "Percentage that Three-Year Rate Exceeds Cohort Default Rate." In 1996, the three-year rate exceeded the cohort default rate by 43.7 percent; in 1999, the three-year rate exceeded the cohort default rate by 80.1 percent.
- Decrease in the "Percentage Change 1996 to 1999" for the percentage of the composition of the three-year rate attributable to the cohort default rate. From 1996 to 1999, the proportion of defaults in the two-year cohort period decreased by 20.2 percent. Public and private schools decreased 8.5 percent and 11.2 percent, respectively.

Recommendations:

To provide decision makers with sufficient information on defaults in the Title IV loan programs, we recommend that the Assistant Secretary for Postsecondary Education and the Chief Operating Officer for Federal Student Aid

1.1. Develop and publish annually a life of cohort default rate for each cohort. A life of cohort default rate could be calculated using the same methodology employed for cohort default rates, except that with the passage of each FY, the rate would be recalculated using the cumulative number of borrowers who defaulted. The denominator for a given cohort would remain unchanged. A life of cohort default rate would serve as an additional, more comprehensive resource for the Department, Congress, and other decision makers, and would also help verify that cohort default rates calculated under the HEA contain sufficient information on defaults in the Title IV loan programs.[8]

1.2. Support an amendment to the HEA to include in the calculation of cohort default rates the defaults that were excluded by the 1998 Amendments' change in the definition of default. This recommendation could be accomplished in a number of ways: for example, by supporting an amendment to return the definition of default to its previous 180-day delinquency basis, or by supporting an amendment to adjust the cohort default rate calculation to include defaults occurring in the 90-day period following the two-year cohort period.

The objective of Recommendation 1.2 could be accomplished in a number of different ways, depending upon how the Department chooses to implement it. Since these amendments to the HEA could, under some scenarios, affect aspects of the Title IV loan programs outside cohort default rate issues, we encourage the Department to study and identify low-cost, effective options, and to support implementing amendments to the HEA.

[8] A life of cohort default rate would be different from the lifetime default rates calculated by the Department (see Background and Appendix A). Because the Department's lifetime default rates are based on estimates of defaults and are not calculated for individual schools, they are of limited value to FSA, in most cases, for use in its management of the loan programs.

OPE Comments:

In response to Recommendation 1.1, OPE states that FSA's Portfolio Risk Management Group is developing, and plans to publish, a lifetime default rate for the Title IV loan programs. This lifetime default rate will focus on the amount of dollars in default, rather than the number of borrowers in repayment, highlighting the borrower's ability to repay a student loan rather than a school's administration of the program. OPE states that

- A life of cohort default rate for individual schools would be of little use to schools or the Department, because schools have a limited span of control over their borrowers' repayment behavior;

- A life of cohort default rate for school types would be of little use because schools often change from one type to another; and

- Publication of a second measure of default that focuses on the school and school type would be confusing to schools and to the public.

In response to Recommendation 1.2, OPE comments that adjusting the cohort default rate calculation to include defaults occurring in the 90-day period following the two-year cohort period would delay notifications to schools. Schools would not be informed of sanctions before they had packaged students' aid for the next year. This delay could be disruptive and could harm the overall goal of the Title IV programs, which is assuring access to postsecondary education.

OIG Response:

We do not agree with OPE's contention that a life of cohort default rate calculated for individual schools and school types would be of little use, or that issuing such a default rate would be confusing:

- Though a school's ability to compel students to repay their loans may decrease over time, the effects of a good or bad education are much more durable: a school's life of cohort default rate could be an indicator of the school's ability to successfully prepare students for the workforce.

- We have no data to conclude that schools change type (i.e., from proprietary to private, public to private, etc.) with such frequency that a life of cohort default rate could not be calculated effectively.

- With proper disclosure, the publication of a life of cohort default rate would not be any more confusing to schools or the public than is the publication of statutory cohort default rates.

School and school-type life of cohort default rates could help the Department identify schools and school types that pose an unreasonable risk to taxpayer funds. The Department could use these rates to offer assistance to, and formulate policy to address, the schools and school types that pose such a risk. This type of rate could also be used to verify that statutory cohort default rates provide sufficient information on loan program defaults; the lifetime cohort default rate that the Department proposes could not.

Recommendation 1.2 provides for the accomplishment of its objective in a number of ways. OPE's comments only address one example we provide: extending the two-year cohort period to include the following 90-day period. There are other ways that the recommendation's objective may be accomplished. For example, the definition of default could be returned to its previous 180-day basis or the structure of the cohort itself could be reconfigured. In addition, in its comment on our example, OPE does not appear to consider the possibility of changing its processes so that an official cohort default rate could be issued more quickly (for example, by modifying the processes for issuing draft rates).

FINDING NO. 2 – BORROWERS IN DEFERMENT AND FORBEARANCE LOWER SCHOOLS' COHORT DEFAULT RATES

Borrowers may be eligible for deferment or forbearance after entering repayment on their loans.[9] When borrowers are granted deferments or forbearances, they are able to postpone repayment of their loans:

- Under 34 C.F.R. §§ 682.210(a) and 685.204(a), during a deferment, if a borrower's loan is eligible for interest subsidies, periodic principal and interest payments are deferred. If a borrower's loan is not eligible for interest subsidies, principal need not be paid during the deferment period, but interest not paid by the borrower is capitalized.

- Under 34 C.F.R. §§ 682.211(a)(1) and 685.205(a), during a forbearance, a borrower is allowed to temporarily cease payments, extend the time for making payments, or temporarily make smaller payments than previously scheduled.

Lenders are permitted to use forbearances for eligible borrowers in order to assist the borrowers in avoiding default on their student loans. As noted in 34 C.F.R. § 682.211(a)(1), "The Secretary encourages a lender to grant forbearance for the benefit of a borrower or endorser in order to prevent the borrower or endorser from defaulting on

[9] A borrower may be eligible for deferment if the borrower is continuing his or her education, enrolled in a graduate fellowship or rehabilitation training program, unemployed, or experiencing an economic hardship. Borrowers may be eligible for additional types of deferments if their loans meet certain conditions. A borrower may be eligible for forbearance if he or she is unable to make scheduled loan payments due to poor health; completing a medical or dental internship or residency; subject to loan payments that collectively are 20 percent or greater than his or her total monthly income; serving in a specified national service position; subject to certain conditions during a period of local or national emergency or military mobilization; or subject to certain other circumstances.

the borrower's or endorser's repayment obligation, or to permit the borrower or endorser to resume honoring that obligation after default."

Under 34 C.F.R. § 668.183(b), the cohort default rate calculation's denominator includes borrowers who are in deferment and forbearance status, because these borrowers are considered to be in repayment on their loans. During the deferment or forbearance period, a borrower's lack of scheduled payments is not considered a delinquency and is not included in the delinquency period that results in a default. According to 34 C.F.R. § 682.210(a)(7), the delinquency period required to establish default does not run during the deferment and post-deferment grace periods. When these periods expire, unless the lender grants a forbearance, the borrower resumes any delinquency status that existed when the deferment began.

When a lender or servicer grants a deferment or forbearance on a borrower's loan, the deferment or forbearance may help lower a school's cohort default rate. This occurs because the default rate calculation's denominator (the number of borrowers in the cohort) includes borrowers who are in deferment and forbearance status. These borrowers are not required to make payments on their loans and may not have been subject to a risk of default during the two-year cohort period. Borrowers in deferment and forbearance status who are not subject to a risk of default will not be included in the default rate calculation's numerator (the number of cohort borrowers who default). As a result, the number of borrowers who default is divided by a number that is larger than the total number of borrowers who are making payments on their loans and are subject to a risk of default.

As described in this section, we determined the percentage of cohort borrowers in deferment or forbearance on the last day of the two-year cohort period, and we used this data to calculate alternative default rates and alternative/adjusted default rates. Based on our analysis of this information, cohort default rates do not appear to provide decision makers with sufficient information on defaults in the Title IV loan programs, because they do not consider a borrower's deferment or forbearance status, or the borrower's risk of default during the two-year cohort period. Without information that reflects the general trends in defaults, schools may continue to participate in the Title IV programs, even though a significant percentage of their students may default. Defaulted student loans cost taxpayers money.

Percentage of Borrowers in Deferment or Forbearance

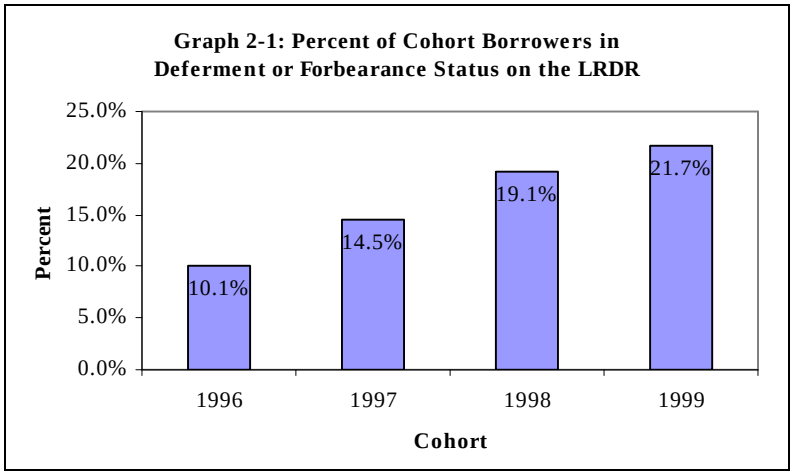
Using Loan Record Detail Report (LRDR) files, we identified the borrowers in each cohort who were in deferment or forbearance status on all their loans that were included in the LRDR. We calculated the percentage of each cohort's borrowers who were in deferment or forbearance status as of the end of the two-year cohort period, the date for which the cohort default rate is calculated.

The results of our calculations are provided in the following table:

Table 2-1: Cohort Borrowers in Deferment (DA) or Forbearance (FB) Status on LRDR

School Type	1996		1997		1998		1999	
	Percent of Cohort	Borrowers in DA or FB Status	Percent of Cohort	Borrowers in DA or FB Status	Percent of Cohort	Borrowers in DA or FB Status	Percent of Cohort	Borrowers in DA or FB Status
Public Schools	11.2%	126,113	15.9%	190,334	20.6%	256,829	23.4%	304,607
Private Schools	8.9%	52,403	12.4%	75,772	16.6%	103,924	19.1%	123,054
Proprietary Schools	8.2%	27,124	13.5%	45,164	18.0%	59,550	20.4%	70,410
Foreign Schools	8.6%	278	11.9%	444	17.9%	752	21.9%	1,012
Unclassified Schools	4.7%	47	2.0%	22	1.1%	12	2.3%	14
Total	10.1%	205,965	14.5%	311,736	19.1%	421,067	21.7%	499,097

The percentage of each cohort's borrowers in deferment or forbearance, identified in Table 2-1, is illustrated in the following graph:



Between the 1996 and 1999 cohorts, the percentage of cohort borrowers in deferment or forbearance status more than doubled, from 10.1 percent for the 1996 cohort to 21.7 percent for the 1999 cohort. This represents a significant increase in the percentage of cohort borrowers in deferment or forbearance status:

- In the 1999 cohort, approximately 1 in 5 borrowers were in deferment or forbearance status.
- In the 1996 cohort, approximately 1 in 10 borrowers were in deferment or forbearance status.
- GAO found that 5.2 percent, or approximately 1 in 20 borrowers, were in deferment or forbearance status in the 1993 cohort.[10]

[10] U.S. General Accounting Office, *Student Loans: Default Rates Need to Be Computed More Appropriately*, GAO/HEHS-99-135, July 1999. While our count of 1996 cohort borrowers in deferment or forbearance status is different from GAO's count, our data supports the trends and issues identified by GAO. GAO found that approximately 96,000 borrowers in the 1993 cohort and 227,000 borrowers in the

Alternative Default Rates

In its July 1999 report, *Student Loans: Default Rates Need to be Computed More Appropriately*, GAO found that if borrowers with loans in deferment or forbearance status were excluded from the cohort default rate calculation's denominator, the 1996 cohort default rate would increase from 9.6 percent to 10.9 percent. We applied GAO's method to calculate alternative default rates for the 1996 through 1999 cohorts. We calculated these alternative default rates using the following formula:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and who default during the two-year cohort period.}}{\text{The number of borrowers who enter repayment in the cohort FY, less borrowers in deferment or forbearance status on the LRDR.}}$$

The results of our calculations are presented in the following table:

Table 2-2: Alternative Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999
Overall					
Alternative Default Rate	10.7%	10.3%	8.6%	7.3%	-32.2%
Cohort Default Rate (CDR)	9.6%	8.8%	6.9%	5.7%	-41.0%
Difference	1.1%	1.5%	1.6%	1.6%	
Difference as Percent of CDR	11.3%	16.9%	23.5%	27.8%	
Public Schools					
Alternative Default Rate	9.6%	9.8%	8.7%	7.3%	-23.7%
Cohort Default Rate	8.5%	8.3%	6.9%	5.6%	-34.1%
Difference	1.1%	1.6%	1.8%	1.7%	
Difference as Percent of CDR	12.6%	18.9%	26.0%	30.4%	
Private Schools					
Alternative Default Rate	7.7%	7.0%	5.7%	4.8%	-37.5%
Cohort Default Rate	7.0%	6.1%	4.7%	3.9%	-44.3%
Difference	0.7%	0.9%	0.9%	0.9%	
Difference as Percent of CDR	9.9%	14.2%	19.9%	23.5%	
Proprietary Schools					
Alternative Default Rate	19.8%	17.9%	13.9%	11.8%	-40.6%
Cohort Default Rate	18.2%	15.4%	11.4%	9.4%	-48.5%
Difference	1.6%	2.4%	2.5%	2.4%	
Difference as Percent of CDR	8.9%	15.6%	22.0%	25.6%	

Note: Amounts have been rounded to one decimal place.

1996 cohort were in deferment or forbearance status. We found that approximately 206,000 borrowers in the 1996 cohort were in deferment or forbearance status. The difference in counts may be the result of different methodology used to identify borrowers in deferment or forbearance status on the LRDR.

Table 2-2 shows that, if borrowers with loans in deferment or forbearance status were excluded from the denominators of the cohort default rate calculations, the 1996 through 1999 cohort default rates would be materially increased. In addition, from 1996 to 1999

- The difference between the alternative default rate and cohort default rate became greater: the difference increased from 11.3 percent of the 1996 cohort default rate to 27.8 percent of the 1999 cohort default rate.
- The alternative default rates experienced a downward trend similar to that of cohort default rates, but the decline is significantly less than that for cohort default rates during the same period.

Public, private, and proprietary school types also experienced these trends.

Alternative/Adjusted Default Rates

As discussed in Finding No. 1, the change in the definition of default may have caused the 1998 and 1999 cohort default rates to be understated by a material amount, compared to what those cohort default rates would have been if the definition had not changed. In order to determine the effect that *both* the change in definition of default and borrowers in deferment or forbearance status may have on cohort default rates, we calculated "alternative/adjusted" default rates that

- Exclude borrowers in deferment or forbearance status from the calculation's denominator and
- Include in the numerator defaults we identified in the 90-day periods following the 1998 and 1999 two-year cohort periods.

We calculated the alternative/adjusted default rates for the 1998 and 1999 cohorts using the following formula:

$$\frac{\text{The number of borrowers who enter repayment in the cohort FY and who default during the two-year cohort period and during the 90 day period following the two-year cohort period.}}{\text{The number of borrowers who enter repayment in the cohort FY, less the number of borrowers in deferment and forbearance status on the LRDR.}}$$

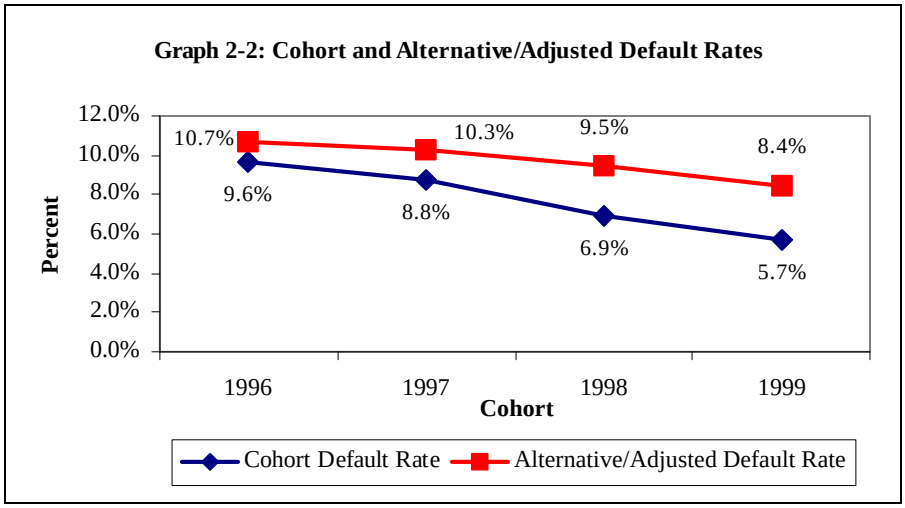
The results of our calculations are provided in the following table:

Table 2-3: Alternative/Adjusted Default Rates

	1996	1997	1998	1999	Percentage Change 1996 to 1999
Overall					
Alternative/Adjusted Default Rate	10.7%	10.3%	9.5%	8.4%	-21.4%
Cohort Default Rate (CDR)	9.6%	8.8%	6.9%	5.7%	-41.0%
Difference	1.1%	1.5%	2.6%	2.7%	
Difference as Percent of CDR	11.3%	16.9%	36.9%	48.2%	
Public Schools					
Alternative/Adjusted Default Rate	9.6%	9.8%	9.6%	8.5%	-11.6%
Cohort Default Rate	8.5%	8.3%	6.9%	5.6%	-34.1%
Difference	1.1%	1.6%	2.7%	2.9%	
Difference as Percent of CDR	12.6%	18.9%	39.7%	51.0%	
Private Schools					
Alternative/Adjusted Default Rate	7.7%	7.0%	6.2%	5.5%	-27.9%
Cohort Default Rate	7.0%	6.1%	4.7%	3.9%	-44.3%
Difference	0.7%	0.9%	1.5%	1.6%	
Difference as Percent of CDR	9.9%	14.2%	32.2%	42.3%	
Proprietary Schools					
Alternative/Adjusted Default Rate	19.8%	17.9%	15.4%	13.8%	-30.3%
Cohort Default Rate	18.2%	15.4%	11.4%	9.4%	-48.5%
Difference	1.6%	2.4%	4.1%	4.5%	
Difference as Percent of CDR	8.9%	15.6%	35.7%	47.4%	

Note: Amounts have been rounded to one decimal place.

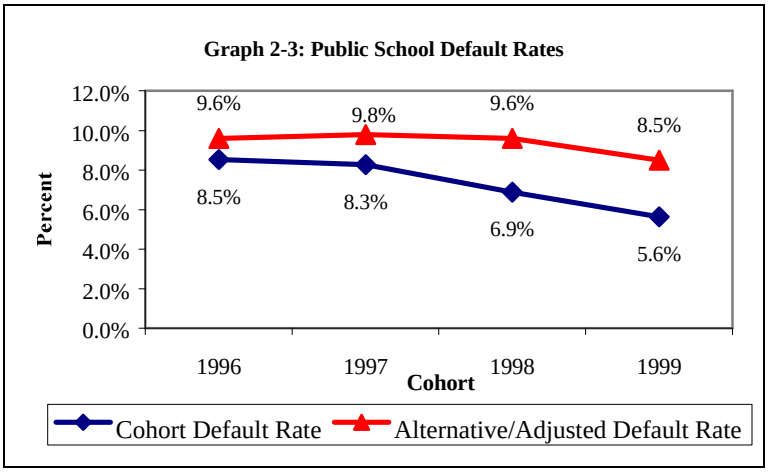
A comparison of the cohort default rates and alternative/adjusted default rates, identified in Table 2-3, is provided in the following graph:



As Table 2-3 and Graph 2-2 show, if borrowers with loans in deferment or forbearance status were excluded from the cohort default rate calculation and the 1998 and 1999 cohort default rates were adjusted for the change in the definition of default, the effect would be a material increase in each of the overall cohort default rates for the 1996 through 1999 cohorts. In addition, from 1996 to 1999

- The difference between the alternative/adjusted default rate and the cohort default rate became greater: the difference increased from 11.3 percent of the 1996 cohort default rate to 48.2 percent of the 1999 cohort default rate.
- The alternative/adjusted default rates experienced a downward trend similar to the trend of cohort default rates, but the decline is materially less than the decline of cohort default rates during the same period.

For the 1996 through 1999 cohorts, the overall alternative/adjusted default rates and the alternative/adjusted default rates for private and proprietary schools declined each year. However, alternative/adjusted default rates for public schools did not experience the same yearly declines. A comparison of cohort default rates and alternative/adjusted default rates for public schools, identified in Table 2-3, is provided in the following graph:



On average, during the 1996 to 1999 cohorts, public school borrowers comprised the majority of all cohort borrowers (56 percent) and cohort borrowers in deferment or forbearance status (61 percent). As shown in Graph 2-3, the alternative/adjusted default rates for public schools remained relatively unchanged for the 1996 through 1998 cohorts.

The measured decline of 1.1 percent (9.6 percent to 8.5 percent) in public schools' alternative/adjusted default rates for the 1996 through 1999 cohorts occurred between the 1998 and 1999 cohorts. Though public schools' 1996 through 1999 alternative/adjusted default rates declined by 11.6 percent, this decline is materially less than the declines during the same period for private schools and for proprietary schools.

Recommendations:

To provide decision makers with sufficient information on defaults in the Title IV loan programs, we recommend that the Assistant Secretary for Postsecondary Education and the Chief Operating Officer for Federal Student Aid support amendments to the HEA that

2.1 Exclude from the cohort default rate calculation borrowers who are not subject to a risk of default during the two-year cohort period, because their loans are in deferment or forbearance status.

2.2 Include the borrowers who are excluded from a cohort default rate calculation by Recommendation 2.1 in a subsequent cohort, when the deferment or forbearance ends and they are subject to a risk of default.

The objective of these recommendations could be accomplished in a number of different ways, depending upon how the Department chooses to implement them. Since these amendments to the HEA could, under some scenarios, require substantial expenditures for systems' modifications, we encourage the Department to study and identify low-cost, effective options, and to support implementing amendments to the HEA.

OPE Comments:

OPE states that excluding from the cohort default rate calculation borrowers whose loans are in a deferment or forbearance status could result in more schools having "fewer than 30 loans in repayment." As a result, more schools' cohort default rates would be based on the average number of defaults in the three most recent cohorts, under the alternative cohort default rate calculation provided in Section 435(m)(1)(C) of the HEA, and more schools may be eligible for certain regulatory appeals.

OIG Response:

We acknowledge that the implementation of our recommendations could increase the number of schools with fewer than 30 borrowers in a cohort. However, this increase should only occur during a short transition period. Though a borrower would be removed from a cohort based on a deferment or forbearance status, the same borrower would be included in a later cohort, once the deferment or forbearance status ended: the cumulative number of borrowers in cohorts would remain unchanged. In addition, the Department currently has cohort default rate regulations and procedures for schools with fewer than 30 borrowers in a cohort.

OTHER MATTERS

Other Reasons Cohort Default Rates May Not Provide Sufficient Information.

Some other reasons why cohort default rates may not provide decision makers with sufficient information on Title IV loan program defaults are provided below:

- Cohort default rates reflect defaults during the two-year cohort period, not the life of the loan, which can be up to 30 years depending on the loan type and repayment plan.
- PLUS loans and certain Consolidation loans are guaranteed by the government but excluded from the cohort default rate calculation.
- Cohort default rates are calculated based upon the number of borrowers in a cohort, and not upon the number of loans or the loan amounts.

We did not examine the significance, if any, of these factors.

Effect of Change in Definition of Default on Reducing Defaults

The 1998 Amendments' change in the definition of default (see Background and Finding No. 1) was one of several savings measures enacted to offset the cost associated with changing the formula for lenders' student loan interest subsidies.[11] 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.

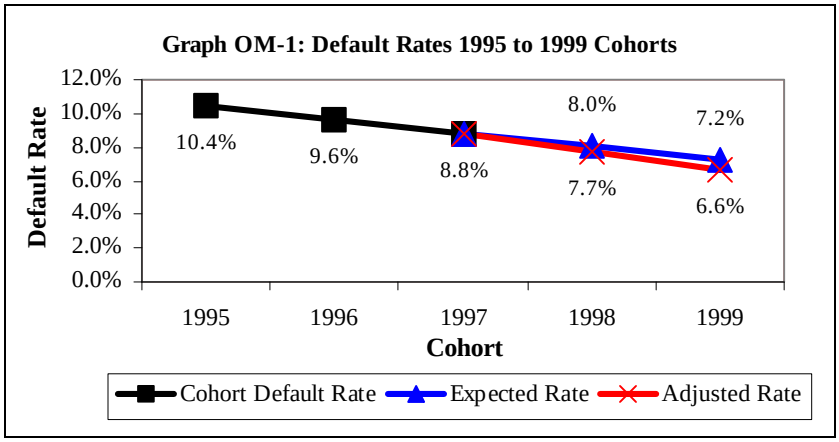
The estimate of these cost savings appears to have been based on the delay of the estimated cash flows associated with defaulted loans by 90 days (thereby reducing the present value of the estimated cash flows) and on the implementation of default aversion activities during the 90-day period, which were expected to result in fewer defaults. However, the data we obtained during our audit did not appear to reflect a material reduction in the number of defaults beyond what would have been expected.

To determine if the change in the definition of default had a material impact on reducing defaults, we estimated expected cohort default rates for the 1998 and 1999 cohorts using a regression analysis of the 1995 through 1997 cohort default rates. In the following table, we compare these expected default rates with the adjusted default rates we calculated in Finding No. 1:

Cohort	Expected Default Rate	Adjusted Default Rate	Expected vs. Adjusted Default Rate Difference
1998	8.0%	7.7%	0.3%
1999	7.2%	6.6%	0.6%

[11] Congressional Research Service Report for Congress, *Student Loans: 1998 Amendments*, 98-291 EPW, February 19, 1999.

The comparison in the preceding table is illustrated in the following graph:



Since the definition change was applicable for loans for which the first day of delinquency occurred on or after October 7, 1998, cohort default rates for the 1998 and subsequent cohorts were impacted by the definition change. If defaults by borrowers in the 1998 and 1999 cohorts declined at a rate materially greater than the expected trend, the graph of adjusted default rates should exhibit a materially steeper decline from the 1997 to 1999 cohorts.

As the preceding table and Graph OM-1 show, 1998 and 1999 adjusted default rates did not decline by materially greater amounts than would be expected, based upon the trend established by the 1995 to 1997 cohort default rates. As a result, if other factors affecting the frequency of borrower default remained constant, the change in definition of default from a 180-day to 270-day delinquency does not appear to have had a material impact on reducing the number of defaults in the 1998 and 1999 cohorts beyond what would have been expected, had the cohort default rates continued the decline experienced in the 1995 to 1997 cohorts.

In addition to the 1998 Amendments' change to the definition of default, the decline in the 1998 and 1999 adjusted default rates could have been the result of a number of other factors that affect the frequency of borrower default: economic growth, lower unemployment, default management activities (i.e., removal of schools from the loan programs, collection efforts), or other factors.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of our audit was to determine if cohort default rates, as calculated under the HEA, provide sufficient information on defaults in the Title IV loan programs. Our audit covered the 1996 through 1999 cohort periods and the following FYs, as detailed below:

Cohort	Two-Year Cohort Period	Extended Period
1996	10/1/95 to 9/30/97	10/1/97 to 9/30/98
1997	10/1/96 to 9/30/98	10/1/98 to 9/30/99
1998	10/1/97 to 9/30/99	10/1/99 to 9/30/00
1999	10/1/98 to 9/30/00	10/1/00 to 9/30/01

To accomplish our objective, we held discussions with officials from the Department's FSA Default Management (DM), FSA National Student Loan Data System (NSLDS), the NSLDS contractor, and the Department's OPE Policy, Planning & Innovation, to gain an understanding of how cohort default rates are calculated and their use by ED. We reviewed laws, regulations, and program office guidance applicable to cohort default rates. We reviewed publications and materials on the Department's FSA organization and Title IV loan programs. We reviewed prior OIG and GAO reports pertinent to the audit objective. We obtained loan program data from the Department's Office of the Under Secretary, Budget Service.

We employed the following methodology to identify defaults in the FY following each two-year cohort period (the extended cohort period):

- The complete LRDR populations for each of the 1996 to 1999 cohorts were obtained from the Department's contractor.
- We segregated each cohort's LRDR loan population into two data sets. The first data set consisted of the loans for all borrowers who entered repayment and who defaulted during the two-year cohort period (LRDR usage codes "B" and "E"). The second data set consisted of the loans for all borrowers who entered repayment and who did not default during the two-year cohort period (LRDR usage codes "D" and "E").
- We removed contradictory records from the data set containing the loans for all borrowers who entered repayment and who did not default during the two-year cohort period. This was accomplished by (1) removing any duplicate borrowers at the same school, and (2) removing any of the borrowers who were identified, in other records, as also having defaulted (LRDR loan usage code "B").
- In June 2002, we obtained the entire table of FFELP default claim records and Direct Loan default records recorded on the NSLDS (the default table).
- We compared the data set containing the loans for all borrowers who did not default during the two-year cohort period to the default table and identified borrowers whose loans had defaulted prior to or during the original two-year cohort period. The identified borrowers were omitted from further analysis.
- We compared the remaining records in the data set containing the loans for all borrowers who did not default during the two-year cohort period to the default table and identified borrowers whose loans defaulted during the extended cohort period.

- We identified the populations of FFELP and Direct Loan consolidation loans associated with each cohort's borrowers who did not default during the two-year cohort period (LRDR usage codes "N"). We compared these consolidation loan populations to the default table and identified borrowers with consolidation loans that had defaulted during the extended cohort period. ED's processing logic was then applied to determine if a link from the defaulted consolidation loan to the underlying loans was available. If a link was available, we considered the borrower to have defaulted during the extended cohort period.

At each stage, we allocated the population of borrowers in default between those that occurred during the first 90 days of each extended cohort period (October 1st through December 29th) and those that occurred after the first 90 days of the extended cohort period (December 30th through September 30th). We summarized the extended cohort period default records by school type, using OPE identification numbers and school type/program length data. Based upon a regression analysis of the 1995 through 1997 cohort default rates, we estimated expected cohort default rates for the 1998 and 1999 cohorts.

Using the populations of borrowers who defaulted in the extended cohort periods and the numerator and denominator counts from the cohort default rates, we calculated default rates for

- Defaults occurring in the three-year period, which includes the original two-year cohort period and the extended cohort period;
- Defaults occurring in the extended cohort period (the third year); and
- Defaults occurring in the original cohort period and an additional 90 days.

We identified the number of borrowers in each cohort who were in deferment or forbearance status, based on data in the LRDR. We calculated default rates that excluded borrowers in deferment and forbearance status from the cohort default rate calculation's denominator and adjusted the calculation's numerator for the change in definition of default by including defaults recognized in the 90-days following the 1998 and 1999 cohort periods. We analyzed the calculated default rates. For purposes of our analysis, we deemed percentage deviations of 10 percent or greater to be material.

To achieve the audit objective, we relied extensively on computer-processed data contained in the NSLDS, specifically the LRDR's loan records for all borrowers who entered repayment and who did not default during the two-year cohort period, FFELP insurance claims payment table, and Direct Loan Program default rate default table. We assessed the reliability of this data by reviewing the PriceWaterhouseCoopers NSLDS Data Quality Assessments, dated June 1999 and December 2001; comparing file record counts; and performing logic tests on the data. We compared record counts from the LRDR files to counts of cohort borrowers and defaulters issued by FSA DM and concluded that the data files provided by the Department were reasonably complete.

We performed tests of the population of defaults identified in the extended cohort period. These tests included determining if a sufficient number of days had elapsed between the

date the loan entered repayment and the default date, determining if the FFELP insurance claim payment date was prior to the reinsurance claim payment date, determining if defaulted Direct Loans had been held by the Department, and determining if the default date for Direct Loan defaults was on or prior to the date the loan was transferred to the Department. As noted above, we omitted contradictory records from the population of records reviewed for defaults in the extended cohort period. While discrepancies and contradictory records were noted during the testing, the percentage of records with potential conflicting data was not significant given the volume of data evaluated. The impact of these records is minimal to the results of our analysis. Based upon the final data reliability assessment performed, we concluded the default data is sufficiently reliable for use in meeting the audit objective.

We also relied upon borrowers' loan status contained in the LRDR. We did not perform tests on the validity of borrower's loan status code contained in the LRDR. Schools and data managers are provided opportunities to correct erroneous loan data prior to the issuance of the official cohort default rates. In identifying borrowers in deferment or forbearance status, we included only borrowers who had a loan status code of deferment or forbearance for all their loans. Our analysis was based upon the effective loan status codes for the end of the two-year cohort period that are contained in the LRDR. These codes were based on information available on the NSLDS at the time the cohort default rate was calculated. As noted above, we concluded that the LRDR files provided by the Department were reasonably complete. Based upon our preliminary data reliability assessment, we conclude the loan status data contained in the LRDR is sufficiently reliable for use in meeting the audit objective.

An assessment of management controls over the cohort default rate calculation was not necessary to achieve the audit's objective. As a result, we did not perform an assessment to determine if the management controls are adequate and functioning as intended. To achieve the objective of our audit, we gained an understanding of how cohort default rates are calculated through discussions with FSA officials and reviews of pertinent policies, procedures, and practices.

We conducted the audit fieldwork at FSA's offices in Washington, D.C., on June 5 and 6, 2002 and February 11, 2003. Additional work was performed at OIG offices in Philadelphia, Pennsylvania, and Boston, Massachusetts. An exit conference was held on September 17, 2003. We conducted our audit in accordance with generally accepted government audit standards appropriate to the scope of the audit work described above.

APPENDIX A – GROSS DEFAULT RATES BY RISK CATEGORY

The default rates provided in the table below are used by the Department to develop loan program cost estimates, and represent projected defaults over the life of the loan cohort. They are not the same as cohort default rates calculated under the HEA. The Department uses risk categories for its estimates of subsidy rates, because costs vary widely within the loan programs, depending on the characteristics of the borrower.

Gross Default Rates by Risk Category

Budget Fiscal Year	**1998**	**1999**	**2000**	**2001**	**2002**
Default Rate Year	**1996**	**1997**	**1998**	**1999**	**2000**
FFELP Subsidized Loans:					
4 year college, 1st and 2nd year students	21.5%	30.6%	19.6%	19.7%	19.3%
4 year college, 3rd and 4th year students	15.2%	19.1%	13.1%	13.2%	12.6%
2 year college, all students	31.2%	39.8%	32.7%	32.7%	30.5%
Proprietary school, all students	37.8%	50.8%	49.1%	49.3%	44.6%
Graduate students	10.4%	11.9%	8.8%	8.9%	8.2%
FFELP Unsubsidized Loans:					
4 year college, 1st and 2nd year students	21.9%	30.3%	19.1%	20.0%	19.7%
4 year college, 3rd and 4th year students	15.4%	19.8%	13.1%	13.1%	12.5%
2 year college, all students	31.0%	42.3%	32.1%	32.1%	29.6%
Proprietary school, all students	37.5%	43.5%	48.0%	48.2%	42.9%
Graduate students	10.3%	12.4%	8.7%	8.7%	8.1%
FFELP PLUS Loans	9.6%	11.1%	9.8%	10.9%	9.2%
Direct Loan Program Subsidized Loans:					
4 year college, 1st and 2nd year students	22.5%	30.6%	19.9%	20.0%	19.4%
4 year college, 3rd and 4th year students	15.1%	19.1%	13.1%	13.2%	12.5%
2 year college, all students	31.6%	39.8%	33.0%	33.3%	30.5%
Proprietary school, all students	37.7%	49.9%	49.2%	49.5%	44.1%
Graduate students	10.4%	11.9%	8.8%	8.8%	8.1%
Direct Loan Program Unsubsidized Loans:					
4 year college, 1st and 2nd year students	22.4%	30.3%	20.0%	20.0%	19.4%
4 year college, 3rd and 4th year students	15.2%	19.8%	13.0%	13.0%	12.3%
2 year college, all students	31.2%	42.3%	31.1%	32.5%	29.5%
Proprietary school, all students	37.5%	43.5%	48.0%	48.4%	42.3%
Graduate students	10.2%	12.4%	8.7%	8.7%	8.0%
Direct Loan PLUS Loans:	8.5%	10.4%	9.3%	9.4%	8.8%

Source: Annual Budgets of the U.S. Government.

APPENDIX B – DEFAULT DATA

Cohort Default Rates.

	1996			1997			1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**8.5%**	**95,973**	**1,124,086**	**8.3%**	**99,300**	**1,200,465**	**6.9%**	**85,741**	**1,245,697**	**5.6%**	**73,318**	**1,303,020**
Less than 2 yrs	10.7%	695	6,508	10.7%	688	6,411	8.5%	542	6,390	7.1%	408	5,768
2-3 yrs	13.3%	35,996	270,232	12.7%	36,344	286,041	10.7%	31,849	297,220	8.9%	27,485	310,412
4 yrs+	7.0%	59,282	847,346	6.9%	62,268	908,013	5.7%	53,350	942,087	4.6%	45,425	986,840
Private	**7.0%**	**40,895**	**586,324**	**6.1%**	**37,660**	**613,143**	**4.7%**	**29,594**	**626,931**	**3.9%**	**25,049**	**645,873**
Less than 2 yrs	21.4%	1,037	4,855	19.2%	898	4,672	14.4%	493	3,424	13.4%	426	3,173
2-3 yrs	12.4%	3,477	27,966	11.0%	3,010	27,405	8.4%	2,194	26,146	6.7%	1,460	21,902
4 yrs+	6.6%	36,381	553,503	5.8%	33,752	581,066	4.5%	26,907	597,361	3.7%	23,163	620,798
Proprietary	**18.2%**	**60,299**	**330,974**	**15.4%**	**51,704**	**334,796**	**11.4%**	**37,532**	**330,356**	**9.4%**	**32,390**	**345,417**
Less than 2 yrs	22.0%	25,843	117,544	18.5%	20,895	113,131	14.2%	14,277	100,716	10.9%	10,430	95,643
2-3 yrs	16.7%	24,544	146,877	14.2%	21,343	149,956	10.4%	15,540	149,661	9.1%	14,459	158,836
4 yrs+	14.9%	9,912	66,553	13.2%	9,466	71,709	9.6%	7,715	79,979	8.2%	7,501	90,938
Foreign	**4.8%**	**155**	**3,221**	**4.3%**	**159**	**3,721**	**3.7%**	**155**	**4,202**	**2.2%**	**102**	**4,618**
Unclassified	**1.6%**	**16**	**990**	**0.8%**	**9**	**1,128**	**0.6%**	**6**	**1,076**	**0.3%**	**2**	**605**
Total	**9.6%**	**197,338**	**2,045,595**	**8.8%**	**188,832**	**2,153,253**	**6.9%**	**153,028**	**2,208,262**	**5.7%**	**130,861**	**2,299,533**

Adjusted Default Rates (See Finding No. 1).

	1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**7.6%**	**95,043**	**1,245,697**	**6.5%**	**84,846**	**1,303,020**
Less than 2 yrs	9.5%	607	6,390	8.2%	471	5,768
2-3 yrs	11.9%	35,439	297,220	10.3%	31,949	310,412
4 yrs+	6.3%	58,997	942,087	5.3%	52,426	986,840
Private	**5.2%**	**32,671**	**626,931**	**4.5%**	**28,849**	**645,873**
Less than 2 yrs	16.6%	569	3,424	15.3%	485	3,173
2-3 yrs	9.0%	2,342	26,146	7.6%	1,654	21,902
4 yrs+	5.0%	29,760	597,361	4.3%	26,710	620,798
Proprietary	**12.6%**	**41,720**	**330,356**	**11.0%**	**38,039**	**345,417**
Less than 2 yrs	15.6%	15,667	100,716	12.8%	12,206	95,643
2-3 yrs	11.6%	17,354	149,661	10.7%	17,006	158,836
4 yrs+	10.9%	8,699	79,979	9.7%	8,827	90,938
Foreign	**3.9%**	**163**	**4,202**	**2.4%**	**112**	**4,618**
Unclassified	**0.6%**	**6**	**1,076**	**0.3%**	**2**	**605**
Total	**7.7%**	**169,603**	**2,208,262**	**6.6%**	**151,848**	**2,299,533**

Third-Year Default Rates (See Finding No. 1).

	1996			1997			1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**3.6%**	**40,367**	**1,124,086**	**2.7%**	**31,841**	**1,200,465**	**2.8%**	**35,244**	**1,245,697**	**3.1%**	**40,587**	**1,303,020**
Less than 2 yrs	4.8%	314	6,508	4.6%	292	6,411	4.5%	287	6,390	4.8%	277	5,768
2-3 yrs	5.4%	14,572	270,232	4.1%	11,728	286,041	4.5%	13,509	297,220	5.0%	15,555	310,412
4 yrs+	3.0%	25,481	847,346	2.2%	19,821	908,013	2.3%	21,448	942,087	2.5%	24,755	986,840
Private	**2.9%**	**17,145**	**586,324**	**2.0%**	**12,455**	**613,143**	**2.0%**	**12,495**	**626,931**	**2.3%**	**14,981**	**645,873**
Less than 2 yrs	8.1%	392	4,855	7.1%	333	4,672	7.3%	250	3,424	6.8%	217	3,173
2-3 yrs	4.6%	1,277	27,966	3.3%	906	27,405	3.3%	859	26,146	4.5%	984	21,902
4 yrs+	2.8%	15,476	553,503	1.9%	11,216	581,066	1.9%	11,386	597,361	2.2%	13,780	620,798
Proprietary	**8.0%**	**26,395**	**330,974**	**6.4%**	**21,400**	**334,796**	**6.8%**	**22,574**	**330,356**	**7.5%**	**25,945**	**345,417**
Less than 2 yrs	9.3%	10,903	117,544	7.6%	8,562	113,131	7.9%	8,005	100,716	9.2%	8,774	95,643
2-3 yrs	7.2%	10,579	146,877	5.8%	8,755	149,956	6.7%	9,990	149,661	7.2%	11,509	158,836
4 yrs+	7.4%	4,913	66,553	5.7%	4,083	71,709	5.7%	4,579	79,979	6.2%	5,662	90,938
Foreign	**2.5%**	**80**	**3,221**	**1.4%**	**51**	**3,721**	**1.2%**	**51**	**4,202**	**1.4%**	**65**	**4,618**
Unclassified	**0.6%**	**6**	**990**	**0.4%**	**5**	**1,128**	**0.1%**	**1**	**1,076**	**0.5%**	**3**	**605**
Total	**4.1%**	**83,993**	**2,045,595**	**3.1%**	**65,752**	**2,153,253**	**3.2%**	**70,365**	**2,208,262**	**3.5%**	**81,581**	**2,299,533**

Three-Year Default Rates (See Finding No. 1).

	1996			1997			1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**12.1%**	**136,340**	**1,124,086**	**10.9%**	**131,141**	**1,200,465**	**9.7%**	**120,985**	**1,245,697**	**8.7%**	**113,905**	**1,303,020**
Less than 2 yrs	15.5%	1,009	6,508	15.3%	980	6,411	13.0%	829	6,390	11.9%	685	5,768
2-3 yrs	18.7%	50,568	270,232	16.8%	48,072	286,041	15.3%	45,358	297,220	13.9%	43,040	310,412
4 yrs+	10.0%	84,763	847,346	9.0%	82,089	908,013	7.9%	74,798	942,087	7.1%	70,180	986,840
Private	**9.9%**	**58,040**	**586,324**	**8.2%**	**50,115**	**613,143**	**6.7%**	**42,089**	**626,931**	**6.2%**	**40,030**	**645,873**
Less than 2 yrs	29.4%	1,429	4,855	26.3%	1,231	4,672	21.7%	743	3,424	20.3%	643	3,173
2-3 yrs	17.0%	4,754	27,966	14.3%	3,916	27,405	11.7%	3,053	26,146	11.2%	2,444	21,902
4 yrs+	9.4%	51,857	553,503	7.7%	44,968	581,066	6.4%	38,293	597,361	6.0%	36,943	620,798
Proprietary	**26.2%**	**86,694**	**330,974**	**21.8%**	**73,104**	**334,796**	**18.2%**	**60,106**	**330,356**	**16.9%**	**58,335**	**345,417**
Less than 2 yrs	31.3%	36,746	117,544	26.0%	29,457	113,131	22.1%	22,282	100,716	20.1%	19,204	95,643
2-3 yrs	23.9%	35,123	146,877	20.1%	30,098	149,956	17.1%	25,530	149,661	16.3%	25,968	158,836
4 yrs+	22.3%	14,825	66,553	18.9%	13,549	71,709	15.4%	12,294	79,979	14.5%	13,163	90,938
Foreign	**7.3%**	**235**	**3,221**	**5.6%**	**210**	**3,721**	**4.9%**	**206**	**4,202**	**3.6%**	**167**	**4,618**
Unclassified	**2.2%**	**22**	**990**	**1.2%**	**14**	**1,128**	**0.7%**	**7**	**1,076**	**0.8%**	**5**	**605**
Total	**13.8%**	**281,331**	**2,045,595**	**11.8%**	**254,584**	**2,153,253**	**10.1%**	**223,393**	**2,208,262**	**9.2%**	**212,442**	**2,299,533**

Alternative Default Rates (See Finding No. 2).

	1996			1997			1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**9.6%**	**95,973**	**997,973**	**9.8%**	**99,300**	**1,010,131**	**8.7%**	**85,741**	**988,868**	**7.3%**	**73,318**	**998,413**
Less than 2 yrs	11.9%	695	5,855	12.6%	688	5,464	10.5%	542	5,139	9.2%	408	4,429
2-3 yrs	15.2%	35,996	236,081	15.2%	36,344	238,416	13.7%	31,849	231,749	11.8%	27,485	233,231
4 yrs+	7.8%	59,282	756,037	8.1%	62,268	766,251	7.1%	53,350	751,980	6.0%	45,425	760,753
Private	**7.7%**	**40,895**	**533,921**	**7.0%**	**37,660**	**537,371**	**5.7%**	**29,594**	**523,007**	**4.8%**	**25,049**	**522,819**
Less than 2 yrs	24.1%	1,037	4,310	22.9%	898	3,915	17.7%	493	2,781	16.1%	426	2,654
2-3 yrs	13.5%	3,477	25,819	12.4%	3,010	24,347	10.0%	2,194	21,886	8.3%	1,460	17,493
4 yrs+	7.2%	36,381	503,792	6.6%	33,752	509,109	5.4%	26,907	498,340	4.6%	23,163	502,672
Proprietary	**19.8%**	**60,299**	**303,850**	**17.9%**	**51,704**	**289,632**	**13.9%**	**37,532**	**270,806**	**11.8%**	**32,390**	**275,007**
Less than 2 yrs	24.1%	25,843	107,061	21.7%	20,895	96,226	17.6%	14,277	81,105	13.8%	10,430	75,519
2-3 yrs	18.2%	24,544	135,017	16.4%	21,343	130,340	12.5%	15,540	123,910	11.3%	14,459	127,795
4 yrs+	16.0%	9,912	61,772	15.0%	9,466	63,066	11.7%	7,715	65,791	10.5%	7,501	71,693
Foreign	**5.3%**	**155**	**2,943**	**4.9%**	**159**	**3,277**	**4.5%**	**155**	**3,450**	**2.8%**	**102**	**3,606**
Unclassified	**1.7%**	**16**	**943**	**0.8%**	**9**	**1,106**	**0.6%**	**6**	**1,064**	**0.3%**	**2**	**591**
Total	**10.7%**	**197,338**	**1,839,630**	**10.3%**	**188,832**	**1,841,517**	**8.6%**	**153,028**	**1,787,195**	**7.3%**	**130,861**	**1,800,436**

Alternative/Adjusted Default Rates (See Finding No. 2).

	1996			1997			1998			1999		
School Type	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**	**Rate**	**Defaults**	**Borrowers**
Public	**9.6%**	**95,973**	**997,973**	**9.8%**	**99,300**	**1,010,131**	**9.6%**	**95,043**	**988,868**	**8.5%**	**84,846**	**998,413**
Less than 2 yrs	11.9%	695	5,855	12.6%	688	5,464	11.8%	607	5,139	10.6%	471	4,429
2-3 yrs	15.2%	35,996	236,081	15.2%	36,344	238,416	15.3%	35,439	231,749	13.7%	31,949	233,231
4 yrs+	7.8%	59,282	756,037	8.1%	62,268	766,251	7.8%	58,997	751,980	6.9%	52,426	760,753
Private	**7.7%**	**40,895**	**533,921**	**7.0%**	**37,660**	**537,371**	**6.2%**	**32,671**	**523,007**	**5.5%**	**28,849**	**522,819**
Less than 2 yrs	24.1%	1,037	4,310	22.9%	898	3,915	20.5%	569	2,781	18.3%	485	2,654
2-3 yrs	13.5%	3,477	25,819	12.4%	3,010	24,347	10.7%	2,342	21,886	9.5%	1,654	17,493
4 yrs+	7.2%	36,381	503,792	6.6%	33,752	509,109	6.0%	29,760	498,340	5.3%	26,710	502,672
Proprietary	**19.8%**	**60,299**	**303,850**	**17.9%**	**51,704**	**289,632**	**15.4%**	**41,720**	**270,806**	**13.8%**	**38,039**	**275,007**
Less than 2 yrs	24.1%	25,843	107,061	21.7%	20,895	96,226	19.3%	15,667	81,105	16.2%	12,206	75,519
2-3 yrs	18.2%	24,544	135,017	16.4%	21,343	130,340	14.0%	17,354	123,910	13.3%	17,006	127,795
4 yrs+	16.0%	9,912	61,772	15.0%	9,466	63,066	13.2%	8,699	65,791	12.3%	8,827	71,693
Foreign	**5.3%**	**155**	**2,943**	**4.9%**	**159**	**3,277**	**4.7%**	**163**	**3,450**	**3.1%**	**112**	**3,606**
Unclassified	**1.7%**	**16**	**943**	**0.8%**	**9**	**1,106**	**0.6%**	**6**	**1,064**	**0.3%**	**2**	**591**
Total	**10.7%**	**197,338**	**1,839,630**	**10.3%**	**188,832**	**1,841,517**	**9.5%**	**169,603**	**1,787,195**	**8.4%**	**151,848**	**1,800,436**

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

MEMORANDUM

DATE DEC 16 2003

TO Bernard Tadley
Regional Inspector General for Audit
U S Department of Education

FROM Sally L Stroup

SUBJECT Comments on Draft Audit Report – Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in Title IV Loan Programs (Control Number ED-OIG/A03-C0017)

The Office of Postsecondary Education, along with Federal Student Aid with whom we have worked in developing this response, are pleased with your efforts to review the calculation of cohort default rates Your report indicates that cohort default rates provide the information required under the Higher Education Act (HEA) but recommends that changes in statute would provide more meaningful information The work that you have done will inform our efforts related to the reauthorization of the HEA and the development of new measures and metrics in the FFEL and FDSL programs However, we do have concerns with two of your recommendations

Currently, we notify institutions in September of their potential loss of program eligibility associated with cohort default rates that exceed statutory thresholds We believe that implementing your recommendation to extend the numerator of the calculation by 90 days will cause delays in notifying institutions of their potential loss of program eligibility until December This will delay our ability to inform institutions of any sanctions prior to their packaging of aid for students for the subsequent academic year This could be extremely disruptive and adversely impact the overall goal of the HEA programs of assuring access to postsecondary education

Also, with regard to the inclusion of loans that were in forbearance and deferment during the two-year cohort period, it would seem that the exclusion of these loans could result in

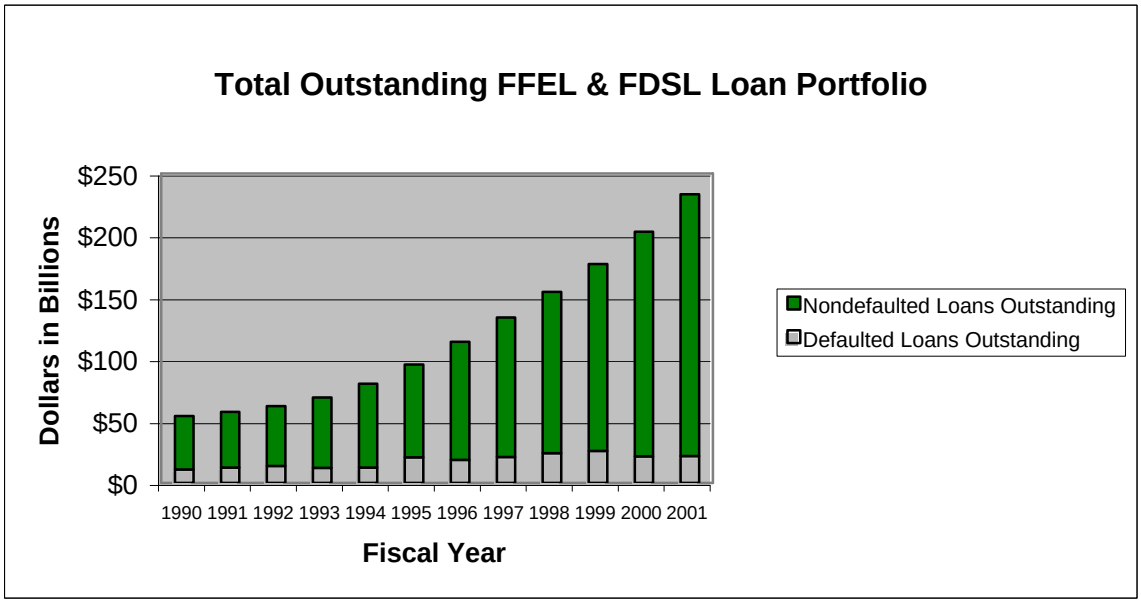
more institutions being subject to the exception for institutions with fewer than 30 loans in repayment or to the three-year average rules. We will be examining the use of forbearances and deferments this fall so that we are ready to make appropriate recommendations when we submit HEA reauthorization proposals, if appropriate, early next year.

As part of its FY 2004 Annual Plan activities, FSA will develop several new measures in which to demonstrate success of its default management and prevention strategies. As part of this commitment, the Portfolio Risk Management Group is developing, with subsequent plans to publish, a lifetime default rate for the Title IV loan programs. The lifetime default rate is another tool that will be utilized to reduce risk of loss to the taxpayer. By monitoring default rates during the entire life of the loan, FSA will be able to recognize trends during the repayment cycle that will provide opportunities for identifying and reducing risk factors, in addition to monitoring its success in keeping defaults at low levels.

We anticipate that the rate will be based on the cohort year and provide default activity for the life of the loan. For instance, loans with a cohort year of 1996 will be monitored annually beginning with 1997 through the payoff of the loan. The lifetime default rate will focus on the amount of dollars in default, rather than the number of borrowers in repayment, highlighting the borrower's ability to repay a student loan rather than the school's administration of the program. To develop and publish a lifetime default rate by school would be of little utility to schools and the Department. The school has a limited span of control over borrowers' repayment behavior, within the two-year period as defined in the cohort default rate. The development of a lifetime default rate by sector will also be of little utility because schools often change their institution type affecting the consistency of a lifetime rate following a static cohort of borrowers. Additionally, publication of a second measure of default that focuses on the school and sector level would be confusing to schools and the public.

We anticipate that the Department will make decisions related to the administration's reauthorization proposals of the HEA early next year. At that time, we will seriously consider the recommendations for changes to the cohort default rate calculation contained in the draft report.

Additionally, although your report contained information about the defaults and loan portfolio balances, we recommend including the following chart which we provided to GAO's audit entitled *Federal Student Aid: Timely Performance Plans and Reports Would Help Guide and Assess Achievement of Default Management Goals (GAO-03-348)*.



Although we provided this information to GAO to demonstrate that our default prevention and management strategies were appropriate to guide our efforts in the default management area, it provides a clearer picture of the magnitude of the defaulted portfolio versus the total Direct Loan and FFEL loans outstanding. In addition, we believe that it is important to provide more recent statistics in Table 1 than the FY 1999 balances because, in the more recent years, the outstanding defaulted portfolio is actually decreasing because collections are outpacing the amount of the defaults. We believe that information may be important to the reader and other policy makers as they are reviewing this report.

Again, we appreciate the opportunity to comment on the important issues identified in this draft report and will use this information to inform our HEA Reauthorization proposals. If you have any questions on this response, please feel free to contact David Bergeron at 202-502-7815.

cc: Terri Shaw, FSA
Pat Howard, OIG