

A NEW APPROACH TO COLLEGE ACCOUNTABILITY

Balancing Sanctions and Rewards to Improve Student Outcomes



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Introduction

College accountability should be the backbone of our federal financial aid system, but shortcomings in the current approach limit its effectiveness. We hold students receiving federal student aid accountable for studying and making progress toward a credential, but there are few consequences for schools that fail to graduate large shares of students or consistently leave students with debts they cannot repay. Colleges need to have a greater stake in their students' success and ability to repay their debts. The current all-or-nothing nature of determining eligibility for federal aid under the Title IV of the Higher Education Act gives colleges a strong incentive to avoid crossing a set threshold, but provides little incentive to improve as long as they are below that threshold – regardless of how close to the threshold schools remain. The one-size-fits-all approach of the current system also tends to overregulate the best colleges while under-regulating the worst. Finally, the current debt-based outcome measure, Cohort Default Rates (CDR), distorts the relative risk posed by schools to students and taxpayers by not accounting for a college's student borrowing rate.

To address these shortcomings, we propose replacing the current Title IV eligibility system with a graduated system of risks and rewards that would provide all colleges with greater incentives to improve student outcomes as well as encourage schools that serve students well to enroll more low-income students. Our proposal is designed to complement, rather than replace, other critical accountability structures that serve different purposes, like the “gainful employment” requirement for career education programs and the 90-10 Rule for for-profit colleges.

Specifically, our proposal applies a borrower-weighted debt outcome measure of risk to all Title IV institutions in order to:

- Provide financial and non-financial rewards to low-risk schools that serve low-income students well;
- Establish risk sharing payments that increase as a school's risk to students and taxpayers increases;
- Require risk reduction plans (similar to existing default reduction plans) at a much earlier point than today so that colleges improve much sooner; and
- End Title IV eligibility for schools posing unacceptable levels of risk.

The primary goal of our proposal is to provide effective incentives for schools to improve outcomes for their students by reducing their risk of ending up with debt they cannot pay. We achieve this by including rewards that encourage high-performing schools to innovate and enroll more low-income students, and by assessing penalties that encourage low-performing schools to adopt practices that reduce their risk to students and taxpayers. Our research has found that nearly one million community college students do not have access to federal loans, the safest way to borrow to pay for school.¹ The system we propose also provides an incentive for schools to participate in the federal loan program because offering federal loans would be a requirement for rewards.

Importantly, we have not designed college risk sharing as a form of a tax on all or even most schools. Our proposal targets risk sharing payments to colleges with especially poor outcomes, with payment rates increasing as the colleges approach the eligibility cutoff. Modeled outcomes indicate that many colleges currently would neither qualify for rewards nor be subject to penalties.

¹ TICAS. 2016. *States of Denial: Where Community College Students Lack Access to Federal Student Loans*.
http://ticas.org/sites/default/files/pub_files/states_of_denial.pdf

We also recommend a phased implementation to give schools time to improve and lower their risk before they are subject to sanction. Schools that would meet the criteria for sanctions would be required to develop risk-reduction plans to help them lower their risk before payments are assessed. High-performing schools should have immediate access to rewards to provide an incentive to continue offering federal loans, enroll more low-income students, and to encourage other schools to immediately take steps to improve so they can earn rewards.

No school receiving federal student loans should be exempt from this accountability structure just as their student loan borrowers are not exempt from repayment. Taxpayers should not subsidize schools that consistently leave large shares of students unable to repay their loans. However, in light of the unique circumstances of the establishment and historic underfunding of Historically Black Colleges and Universities (HBCUs), we propose significant new funding for HBCUs to reduce risk and improve student achievement to avoid unintentionally deepening historic, structural inequities with the new accountability structure.²

This working paper builds on our prior work on college accountability.³ In addition to expanding and deepening our proposal, newly available student loan repayment rate data allow us to now analyze the effects of building our proposal around a new metric. Our previous proposal used the Student Default Risk Indicator (SDRI) to assess the risk a particular college poses to students and taxpayers. In this paper, we put forward two borrower-weighted metrics on which a new accountability system could be based: the Student Default Risk Indicator (SDRI) or the Student Non-Repayment Risk Indicator (SNRI). We model the effects of our proposal using each metric to demonstrate their viability, knowing that no single accountability system or metric can address all aspects of college performance or perfectly align incentives. See page 6 for a discussion of important considerations and potential tradeoffs relating to each of these metrics.

Measuring Institutional Risk

Borrowers' ability to repay their loans after college is one important indicator of college quality. Loans enable many students to get a good education, which in turn enables them to repay their loans. However, too many borrowers struggle to repay their loans after leaving school, and as borrowing has become increasingly necessary to attend college, the risk of an education not paying off has grown for students and families as well as for the economy. Yet colleges themselves face few, if any, repercussions when a significant number of their students end up with debt they cannot repay, so long as they stay below the current high, all-or-nothing threshold for how many borrowers end up in default.

Any measure of risk intended to identify schools where colleges' low performance merits 'skin in the game' should identify schools where a high proportion of students face negative consequences related to student debt. To this end, we propose using a *student-based* risk metric to assess school performance. A student-based metric focuses on the number of students facing poor outcomes, as opposed to a borrower-based metric which only assesses borrower outcomes, no matter how many or

² See Title III Part B, Strengthening Historically Black Colleges and Universities Program
<http://www2.ed.gov/programs/iduestitle3b/funding.html>

³ For more information about our original proposal, see TICAS. 2015. *Risk Sharing: A Proposal to Improve Institutional Accountability and Rewards Colleges Using a Student Default Risk Indicator (SDRI)*
http://ticas.org/sites/default/files/pub_files/component/ticas_risk_sharing_response_sdri_one_pager_and_cover_letter_0.pdf
and also Testimony on College Accountability before the Advisory Committee on Student Financial Assistance hearing, Sept 11, 2015, http://ticas.org/sites/default/files/pub_files/jessica_thompson_testimony_on_risk-sharing_1.pdf

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few students borrow, or a dollar-based metric which considers how much total debt students at a school borrow or default on. Dollar-based metrics are a less accurate measure of the risk a college poses to students who face the same, severe consequences of default regardless of the size of their loan balance, and are more appropriately used to assess the size of a penalty that is warranted for high-risk institutions.

By definition, a student-based risk metric must account for the share of students at a school who borrow. Currently, Title IV aid eligibility for schools is determined by using CDRs, which do not account for borrowing rates and thereby distort the relative risk that specific schools pose to students and taxpayers. While CDR rules acknowledge the importance of schools' borrowing rates by providing protection for low-borrowing schools, the process (the Participation Rate Index, known as the PRI) is opaque, complex, and too limited. Weighting a negative repayment outcome by the school's borrowing rate, as both of the metrics we propose do, more explicitly accounts for the risk a school poses to all of its students. It also avoids penalizing schools where a small number of students have bad outcomes, which can inadvertently encourage schools with low relative risk to stop offering federal student loans in order to avoid potential sanctions. Both the SDRI and SNRI, defined below, address these shortcomings.

The SDRI is calculated by multiplying the school's borrowing rate by its official cohort default rate (CDR).

	Cohort Default Rate	Borrowing Rate	Students' Risk of Default	SDRI
School A	20%	90%	18%	18%
School B	20%	5%	1%	1%

The SNRI is calculated by multiplying the school's borrowing rate by its three year non-repayment rate.

	Non-repayment Rate	Borrowing Rate	Students' Risk of Non-repayment	SNRI
School A	60%	90%	54%	54%
School B	60%	5%	3%	3%

Considering Tradeoffs: SDRI vs SNRI

As we demonstrate in this paper, one can achieve similar results in increased accountability whether using the SDRI or the SNRI (see Modeled Effects of Proposal, page 9) to implement our college accountability proposal. However, there are a number of tradeoffs to consider in weighing the use of either metric. Most broadly, any metric used for accountability needs a clear and rational definition, as well as a process to ensure integrity and transparency.

SDRI

The SDRI is based on Cohort Default Rates (CDRs), a longstanding and well-defined measure that is currently used to determine college eligibility for Title IV funding. With default at its center, SDRI helps ensure that accountability measures are focused on what is an unequivocally bad outcome for students, focusing colleges on keeping students out of the worst outcome. From years of use, we know that colleges are able to lower student default rates without reducing students' access to college or financial aid.⁴ However, colleges can and do manipulate their default rates, particularly through the aggressive use of deferments and forbearances.⁵ It is important that administrative, regulatory, and Congressional action be taken to stop these practices, with or without a shift to an SDRI-based risk sharing system.⁶ Additionally, it is important to recognize that the default rate/SDRI thresholds set today may become less meaningful in the future if we successfully adopt policies that automatically move severely delinquent borrowers into income-driven repayment plans, which may lower default rates/SDRIs without colleges increasing student achievement or affordability.

SNRI

The SNRI is promising in part because it allows us to measure a wider range of outcomes than just the worst one. It holds schools accountable not just for default but also for leaving their students unable to make progress in paying off their student loans. Repayment rates are also widely seen as less prone to manipulation than default rates. However, they are not immune to manipulation and Congress would need to adopt measures to prevent their manipulation if repayment rates were to become a cornerstone of accountability. For example, colleges are currently prohibited from making payments to prevent a borrower's default on a student loan. Similar measures would be needed to ensure schools

⁴ There are a number of publications that highlight effective strategies schools have used to reduce student default rates. For example, see TICAS. 2012. *Making Loans Work: How Community Colleges Support Responsible Student Borrowing*. <http://ticas.org/content/pub/making-loans-work>; Chitty, Haley. 2010. *A Blueprint to Lower Default Rates: Default-aversion and degree-completion strategies*. University Business Solutions for Higher Education Management Articles: <http://www.universitybusiness.com/article/blueprint-lower-default-rates>. Accessed December 2, 2016; Dillon, Erin and Robin V. Smiles. 2010. *Lowering Student Loan Default Rates: What One Consortium of Historically Black Institutions Did to Succeed*. http://educationpolicy.air.org/sites/default/files/publications/Default_Rates_HBCU.pdf. Accessed December 2, 2016; Texas Guaranteed Student Loan Corporation. 2000. *Shoulder to Shoulder: The Progress Made by the Texas Student Financial Aid Community in Preventing Defaults*. <http://www.tgslc.org/pdf/shoulder.pdf>. Accessed December 2, 2016; and The Texas Historically Black Colleges and Universities Default Management Consortium. 2004. *Breaking New Ground*. <http://www.tgslc.org/pdf/hbcu.pdf>. Accessed December 2, 2016.

⁵ United States Senate Health, Education, Labor and Pensions Committee. 2012. *For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*. http://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf. Accessed December 2, 2016

⁶ For our specific recommendations for curbing CDR manipulation without legislation, see pages 10-17 of TICAS. 2015. *Comments on Topics for Negotiated Rulemaking*. http://ticas.org/sites/default/files/pub_files/ticas_dtr_neg_reg_comments.pdf

cannot manipulate their repayment rates by making a payment to lower a student's balance below a certain threshold.

Despite growing interest in repayment rates, there is not yet a single established calculation, and our ability to model the impacts of an SNRI metric is limited to the repayment rate made available on the College Scorecard website. This calculation does not include graduate students and is different from other repayment rate calculations. For example, the repayment rate provided on the College Scorecard website measures the share of borrowers who have paid down their *principal* balance by at least one dollar while the repayment rate used in the gainful employment rule and the "borrower defense" regulation, finalized on November 1, measures the share of borrowers who have reduced their *outstanding* balance by at least one dollar during a particular period. Both definitions use at least a one dollar reduction in a borrower's balance to define a borrower in repayment, lumping together a wide variation of repayment outcomes in a way that may not be appropriate or meaningful. We recommend careful analysis of the implications of different repayment rate calculations prior to implementation of an SNRI metric for use within our proposed risk sharing and rewards system. This analysis should also establish an appropriate level of scrutiny of the calculation for each institution, and process for appealing and revising reported rates, as are currently provided for the CDRs.

Beyond the outstanding questions of how to calculate repayment rates, there are other unresolved questions about using repayment rates as the primary metric in an accountability system. For example, holding colleges accountable for students making progress in paying down loans, as opposed to staying out of default, could shift colleges' focus away from default prevention and inadvertently increase defaults. And while colleges can help borrowers with high loan balances avoid default by helping more students graduate, and by facilitating their entrance into an income-driven repayment plan, there is no similarly direct or simple mechanisms through which colleges can help borrowers make payments sufficiently large to pay down their loan principal if their incomes are low. To help ensure borrowers make principal-reducing payments, then, colleges may become more aggressive in seeking ways to reduce students' access to loans in ways that keep debt loads low (so that even small payments reduce principal), which may ultimately harm student access and success.

Where to Set the Thresholds for Sanctions and Rewards

The goal of our proposed accountability system is to provide effective incentives for schools to improve outcomes for their students, not to guarantee that a predetermined fraction of schools always fail. Setting standards that are both fair and manageable for colleges is a critical component of designing a system that *motivates* rather than *punishes* schools. Regardless of which metric is used, it is important that standards are fixed (e.g. not defined as ‘the lowest performing 5% of schools fail, the next 10% make risk sharing payments’, etc.) in order to provide clear, unmoving goalposts for institutions that need to understand how they are expected to perform in order to successfully manage to that standard.

We have set clear, fixed thresholds at points where we believe a reasonable person should agree that the risk to students and taxpayers is unacceptably high. We want schools that fall into the risk sharing range to see the value in lowering students’ risk, and, most importantly, to be able to successfully do so through changed behavior. In fact, most colleges subject to risk sharing penalties under our proposal (using either metric) are sufficiently close to the lower bound of the threshold that moving out of this category is achievable (see page 15).

The SDRI thresholds we recommend in the table below mean that schools would lose Title IV funds when at least 20% of their entire student body, not just borrowers, defaults on their loans. Financial rewards would go to schools where no more than 2% of all students default on their loans.

The SNRI thresholds we recommend mean that schools would lose Title IV funds when at least 70% of their students leave with loans they do not make any progress paying down after three years. Financial rewards would go to schools where no more than 15% of students leave with loans they do not make any progress paying down.

Proposed Thresholds for SDRI and SNRI

Outcome	SDRI	SNRI
Full Rewards	<=2%	<=15%
Non-Financial Rewards	>2% and <=5%	>15% and <=30%
No Impact	>5% and <10%	>30% and <45%
Risk Sharing Payment	>=10% and <20%	>=45% and <70%
Ineligible	>=20%	>=70%

As shown in the table below, the average repayment rates and CDRs among schools in each outcome category are similar whether using the SDRI or the SNRI.⁷ Consistent with how each metric is calculated, schools facing any sanction are more likely to have a higher CDR when risk is measured by the SDRI, and schools facing any sanction are more likely to have a lower repayment rate when risk is measured by the SNRI. However, across both metrics, the lowest performing schools (as indicated by either CDR or repayment rate) are subject to sanctions.

⁷ Averages are calculated among schools for which both SDRI and SNRI can be calculated.

Proposed SDRI and SNRI Thresholds Capture Colleges with Similar Average CDRs and Repayment Rates

Outcome	SDRI ⁸			SNRI ⁹		
	Average SDRI	Average CDR	Average Repayment Rate	Average SNRI	Average CDR	Average Repayment Rate
Full Rewards	1.1%	6.0%	62.6%	8.6%	9.4%	59.7%
Non-Financial Rewards	3.5%	8.5%	53.4%	22.4%	10.3%	54.1%
No Impact	7.2%	13.3%	41.4%	36.8%	12.2%	42.0%
Risk Sharing Payment	13.6%	19.3%	31.4%	54.9%	15.4%	29.0%
Ineligible	24.7%	28.6%	21.3%	76.9%	19.8%	16.5%
TOTAL	6.3%	11.7%	47.3%	29.6%	11.7%	47.3%

Institutional Outcomes: Modeled Effects of Proposal

To the extent possible, we use the most recent institutional level data available at the time CDRs are published. We use FY12 CDR data to allow for the fairest comparison between the SDRI and SNRI metrics, because the most recent repayment data available is calculated for an FY11-FY12 cohort, which most closely aligns with the FY12 CDR cohort. The estimates provided in this demonstrate how colleges would fare under each of the two metrics if our proposed accountability system was in effect today.¹⁰ However, we recommend phased implementation to give institutions time to improve (see page 16), and expect that colleges may end up with more positive outcomes than we project here. Because our primary goal is to encourage schools to improve and lower the risk to students and taxpayers, not to generate revenue, we would expect far fewer schools to be subject to risk sharing or eligibility loss.

⁸ We use the most recent data points available to the department at the time the CDRs are calculated. SDRI is calculated only for schools that have borrowers in repayment for FY 2012, Stafford loan disbursements for 2012-13, and undergraduate borrowing rates reported for 2012-13. An SDRI can be calculated for 4,424 schools. The FY12 Cohort Default Rate (CDR) and number of borrowers entering repayment in FY2012 come from U.S. Department of Education. Three-year Official Cohort Default Rates for Schools <http://www2.ed.gov/offices/OSFAP/defaultmanagement/cdr.html>. Stafford loan disbursements for 2012-13 come from U.S. Department of Education. Federal Student Aid. Data Center.

<http://federalstudentaid.ed.gov/datacenter/>. Undergraduate borrowing rates for 2012-13 come from U.S. Department of Education. National Center for Education Statistics. Integrated Postsecondary Education Data System.

<http://nces.ed.gov/ipeds/>.

⁹ This paper calculates a school's non-repayment rate by taking one minus the three-year repayment rate reported on the College Scorecard's. SNRI is calculated only for schools that have borrowers in repayment for FY 2012, Stafford loan disbursements for 2012-13, undergraduate borrowing rates reported for 2012-13, and three-year repayment rates reported for the FY11-12 pooled cohort. An SNRI can be calculated for 4,188 schools. Three-year repayment rates for the FY11-FY12 pooled cohort come from U.S. Department of Education. College Scorecard Data. <https://collegescorecard.ed.gov/data/> accessed on January 13, 2017. Because the College Scorecard provides the only widely available repayment rate, we are unable to assess the impacts of using different repayment rate formulas to calculate the SNRI.

¹⁰ In some cases, the variables used reflect our actual proposal (e.g., use of the official CDR in the calculation of the SDRI), and in other cases we use variables that are available but would ideally be modified to implement the proposal. For example, we use the only borrowing rate data made public by the Department of Education, which include undergraduate students only. However, the borrowing rate used to calculate SDRI or SNRI should include both undergraduate and graduate students to capture all students. Ideally, the borrowing rate would also include private loans so that schools are not able to lower their risk metric by steering students toward private loans instead of federal loans. Because the Department has very limited private loan data, legislation would need to require that all private loans be certified by schools, and reported to the federal government. Until private loan data are available, the SDRI and SNRI must be calculated using Stafford loans only. Similar to the borrowing rate, the repayment rate provided on the College Scorecard includes only undergraduates, but the calculation used to implement our proposal should also include graduate students.

Using available data and assuming no school improvement, our proposal results in the following outcomes when measuring risk with either the SDRI or SNRI:

- More than half of all schools enrolling at least two-thirds of undergraduates receive financial or non-financial rewards under our proposal;
- About one-fifth of schools enrolling 10% of undergraduates make risk sharing payments; and
- Three percent of schools, enrolling one percent of undergraduates or less, lose eligibility.

Distribution of Outcomes for Colleges Using SDRI and SNRI

Outcome	SDRI			SNRI		
	Threshold	% of Schools	% of UGs Enrolled	Threshold	% of Schools	% of UGs Enrolled
Full Rewards	<=2%	21%	33%	<=15%	24%	41%
Non-Financial Rewards	>2% and <=5%	30%	33%	>15% and <=30%	34%	36%
No Impact	>5% and <10%	29%	24%	>30% and <45%	22%	11%
Risk Sharing Payment	>=10% and <20%	17%	10%	>=45% and <70%	17%	10%
Ineligible	>=20%	3%	0.4%	>=70%	3%	1%
Total		100%	100%		100%	100%

Outcomes by Sector

The tables below detail the impact of our proposal under each metric, by sector, using available data and assuming no school improvement.¹¹ A majority of the colleges in each sector is either rewarded or not affected by the proposal using either SDRI or SNRI. Compared to other schools types, a greater share of for-profit schools has higher SDRIs and SNRIs, resulting in a higher share facing sanctions.

Distribution of Outcomes by College Sector Using SDRI

SDRI Outcome	For-Profit		Nonprofit		4-yr Public		2-yr Public		Total	
	#	%	#	%	#	%	#	%	#	%
Full Rewards	134	9%	410	31%	188	25%	218	29%	950	21%
Non-Financial Rewards	293	19%	508	38%	291	38%	227	30%	1,319	30%
No Impact	583	37%	271	20%	201	26%	227	30%	1,282	29%
Risk Sharing Payment	477	30%	119	9%	78	10%	78	10%	752	17%
Ineligible	89	6%	24	2%	7	1%	1	0%	121	3%
Total	1,576	100%	1,332	100%	765	100%	751	100%	4,424	100%

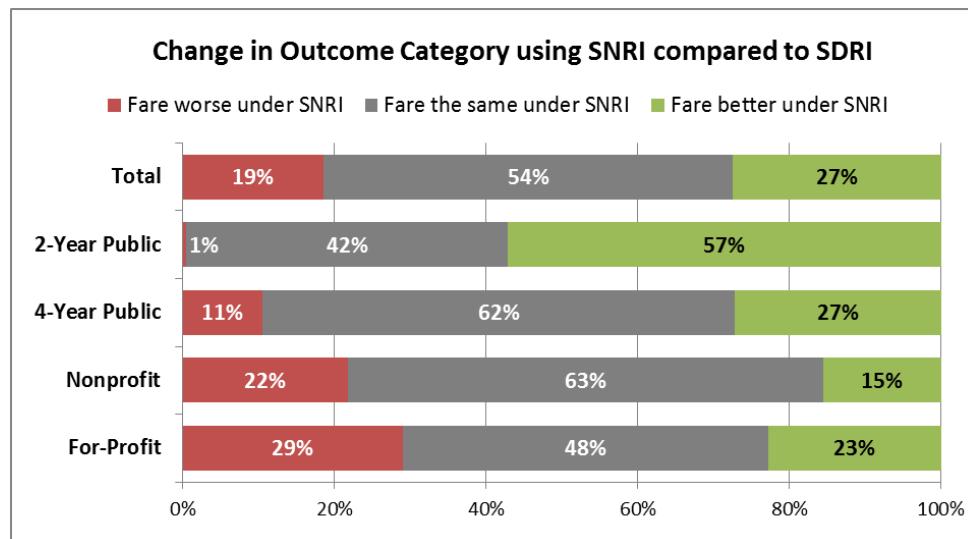
Distribution of Outcomes by College Sector Using SNRI

SNRI Outcome	For-Profit		Nonprofit		4-yr Public		2-yr Public		Total	
	#	%	#	%	#	%	#	%	#	%
Full Rewards	69	5%	319	25%	227	30%	375	51%	990	24%
Non-Financial Rewards	296	20%	511	41%	337	45%	278	38%	1,422	34%
No Impact	479	33%	281	22%	109	14%	66	9%	935	22%
Risk Sharing Payment	508	35%	104	8%	76	10%	16	2%	704	17%
Ineligible	92	6%	39	3%	6	1%	0	0%	137	3%
Total	1,444	100%	1,254	100%	755	100%	735	100%	4,188	100%

¹¹ “2-yr Public” includes public institutions where the highest program offered is an Associate degree. All other public institutions are coded as “4-yr Public”.

Differences in Outcomes under SDRI vs SNRI

The above demonstrates that similar *shares* of schools are captured in each outcome category using either the SDRI or the SNRI. We also examined the extent to which the same school has a similar outcome under both metrics, and which types of schools are more or less likely to be rewarded or subject to sanctions, depending on the metric used. Just over half (54%) of schools face the same outcome regardless of which metric is used. Using available data, for-profit schools are more likely than other sectors to fare worse using the SNRI compared to the SDRI, and two-year public colleges are much more likely than other sectors to fare better using the SNRI. For example, as shown in the graph below, 29% of for-profits fare worse and 57% of community colleges fare better when we use SNRI instead of SDRI.¹²



Rewards: Encouraging Innovation and Protecting College Access

Providing rewards to colleges that serve students well is a core component of our accountability system, designed to help protect and increase access for low-income students. As described earlier, our goal is not to penalize or require risk sharing payments of all schools, but rather to steer schools into adopting practices that lower students' risk of ending up with loans they cannot repay. Sanctions and rewards work together to create an effective accountability structure that incorporates both carrots and sticks. We propose financial and non-financial rewards to encourage and enable high-performing schools to enroll more students and innovate, and incentivize all colleges to improve outcomes in order to receive meaningful rewards. Significantly, the financial rewards would be based on low-income enrollment to both protect and increase access for low-income students, especially under an accountability system that could otherwise inadvertently incentivize schools to alter admissions decisions to control their measured risk.

¹² "Better" means a relatively more positive outcome category, as distinct from a school receiving an objectively positive outcome (e.g., a school that under SDRI would lose eligibility and under SNRI would make risk sharing payments is categorized as having a better outcome).

Under our proposal, all low-risk schools (SDRI <=5% or SNRI <=30%) receive non-financial rewards, and schools with the lowest risk (SDRI <=2% or SNRI <=15%) also receive financial rewards.¹³ Financial rewards provided to colleges could be used to improve college affordability for low-income students or to fund student services (including academic services such as tutoring and counseling), which support students' ability to pay for and succeed in college.

The funding for the proposed rewards should not come from the risk sharing payments collected from high-risk schools because rewards aimed at increasing innovation and low-income enrollment at high performing schools should not be contingent on other schools serving students poorly. Furthermore, if our proposed system works as intended, risk sharing payments should be small and decline over time as schools improve. As such, these funds would not be an appropriate ongoing source of revenue for rewards because the goal is for colleges to reduce risk such that payments are no longer required.¹⁴

Calculating Financial Rewards

Under our proposal, schools with the lowest risk receive financial rewards. The size of their reward is based on their enrollment of Pell Grant recipients, as measured by dividing the school's total Pell disbursement by the year's maximum Pell Grant award (in other words, by measuring the "maximum Pell student equivalent"). Using this measure, rather than the share or number of students receiving Pell Grants, is designed to encourage colleges to help part-time Pell Grant recipients enroll in more courses and also provides more resources to colleges serving the lowest-income students. To estimate a school's financial rewards, we divided a school's total Pell disbursement in Academic Year 2012-13 by that year's maximum Pell Grant award (\$5,500). Assuming \$1 billion total for financial rewards (similar to the amount currently appropriated for the Federal Supplemental Educational Opportunity Grant (FSEOG), eligible schools would receive \$775 for each maximum Pell student equivalent.¹⁵ We then multiplied this Pell enrollment measure by the \$775 bonus amount.

This calculation of rewards targets the largest financial rewards to institutions serving the students with the highest financial need. The table below demonstrates how the value of the financial rewards each school receives will vary significantly based on their Pell enrollment.

Example of Financial Reward Calculation

School	SDRI	SNRI	Maximum Pell Student Equivalent	Reward Amount
School A	<=2%	<=15%	1,000	\$775,000
School B	<=2%	<=15%	10,000	\$7,750,000

The next table shows the total value (rounded to the nearest \$100,000) and share of financial rewards by sector using both SDRI and SNRI, based on existing data and assuming no school improvement. For

¹³ To avoid rewarding schools with low borrowing rates but with default rates that exceed current Title IV eligibility thresholds, schools otherwise eligible for rewards could be prevented from receiving rewards if an additional threshold of CDR30 is applied. Very few schools would be affected by this additional threshold: Under the SDRI metric, an additional 8 schools would be prevented from receiving rewards; under the SNRI metric, an additional 25 schools would be prevented from receiving rewards.

¹⁴ Risk sharing payments could be used to supplement federal funding for need-based aid or improved loan counseling, or to offset costs of student loan discharges, but because the amount of payments will be uncertain and is expected to decline overtime, they should not be relied on for ongoing funding.

¹⁵ For example, a group of ten students each receiving the maximum Pell award amount would be equivalent to \$7,750, whereas a group of ten students receiving the minimum Pell award amount of \$550 would be equivalent to \$775.

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context, the table also includes the distribution of Pell Grant recipients by sector. Using either metric, public schools (where 68% of all Pell students are enrolled) receive more than 80% of the financial rewards.

Distribution of Financial Rewards by College Sector

Sector	Share of all Pell Recipients Enrolled	Using SDRI		Using SNRI	
		Total Financial Reward ¹⁶	% of Financial Rewards	Total Financial Reward	% of Financial Rewards
For-profit	16%	\$21,900,000	2%	\$15,200,000	1%
Nonprofit	15%	\$141,900,000	14%	\$126,500,000	10%
4-Year Public	35%	\$449,300,000	44%	\$485,600,000	39%
2-Year Public	33%	\$401,300,000	40%	\$632,400,000	50%
Total	100%	\$1,014,500,000	100%	\$1,259,600,000	100%

A majority of Pell recipients attend schools that would be rewarded using either the SDRI or SNRI (54% using SDRI, 66% using SNRI).

Distribution of Pell Grant Recipients Across Outcome Categories

SDRI Outcome Category	Share of Pell students	SNRI Outcome Category	Share of Pell students
Full Rewards	23%	Full Rewards	30%
Non-Financial Rewards	31%	Non-Financial Rewards	36%
No Impact	29%	No Impact	15%
Risk Sharing Payment	16%	Risk Sharing Payment	17%
Ineligible	1%	Ineligible	2%
Total	100%	Total	100%

Non-Financial Rewards

Non-financial rewards would go to a wider range of low-risk colleges, and are designed to facilitate innovation that will help students at these schools. For example, rewarded colleges could receive preference for Experimental Sites¹⁷ and for competitive grant selection. The table below shows the distribution of schools that would receive non-financial rewards by sector assuming no school improvement.

Distribution of Non-Financial Rewards by College Sector

Sector	Using SDRI	Using SNRI
For-Profit	22%	21%
Nonprofit	39%	36%
4-Year Public	22%	24%
2-Year Public	17%	20%
Total	100%	100%

¹⁶ We did not adjust the reward amount for each risk metric. Because more schools are financially rewarded using the SDRI metric compared to the SNRI metric, the total and average financial rewards are greater under modeled outcomes for the SDRI.

¹⁷ See <https://experimentalsites.ed.gov> for more information about this initiative, authorized by the Higher Education Act of 1965, as amended, that grants institutional flexibility in order to identify promising institutional practices that support changes to regulations and statute.

Risk Reduction Plans: The Importance of Earlier Intervention

Currently, colleges with a CDR at or above 30% are required to create a default prevention plan, aimed at helping the college reduce defaults before three consecutive default rates at that level affect the school's eligibility for federal aid. Federal law requires that these colleges create a task force to identify factors contributing to their students' default and make a plan to improve student loan repayment. The plans are submitted to the U.S. Department of Education, which is charged with reviewing them and offering technical assistance. These are responsible and appropriate steps. However, this requirement comes too late, after default rates are already unacceptably high, and when colleges have little time to reduce them before being subject to sanctions. Our goal is to require similar plans earlier, when colleges are well below the eligibility loss threshold and at the threshold first requiring risk sharing payments (i.e., when the risk of default is at least 10% or the risk of non-repayment is at least 45%).

Title IV Eligibility Loss

Like today, schools posing unacceptably high levels of risk to students and taxpayers would lose eligibility to Title IV funds. The cutoff points we propose, SDRI $\geq 20\%$ or SNRI $\geq 70\%$, are more than twice times the current average school SDRI and SNRI. Using current data, 3% of schools have an SDRI or SNRI over the cutoff. Given the severe risk posed by schools exceeding this high threshold, we believe it is reasonable that Title IV eligibility loss would occur after a school crosses the SDRI or SNRI threshold. Phased implementation will give schools four years to improve outcomes before they are subject to eligibility loss, and risk reduction plans and risk sharing payments are designed to give schools effective incentives to improve before being subject to losing Title IV eligibility.

The table below shows the distribution of schools by sector that would lose eligibility if schools did not improve during the period of implementation. Totals do not add to 100% due to rounding.

Distribution of Eligibility Loss by College Sector

Sector	Using SDRI	Using SNRI
For-Profit	74%	67%
Nonprofit	20%	28%
4-Year Public	6%	4%
2-Year Public	1%	-
Total	100%	100%

Financial Sanctions: Moving Away from All or Nothing Accountability

Schools with relatively high risk but that are below the eligibility cutoff threshold (SDRI $\geq 10\%$ and $< 20\%$, or SNRI $\geq 45\%$ and $< 70\%$) would be required to develop and implement risk reduction plans and pay a financial sanction. We recommend basing the risk sharing payment on the total defaulted loan balance in the school's cohort default rate. There are other reasonable ways to calculate risk sharing payments. We have previously proposed using annual federal aid or student loan disbursements. However, our calculations using an estimated defaulted loan balance as the base for determining penalties produced payments that we believe are sufficient to prompt schools to improve student outcomes. We note, however, that the precise financial sanction that would be effective at motivating college behavior, without being so burdensome that it would cause irreparable damage, is unknown and should be carefully considered prior to implementation of the proposal.

Additionally, using defaulted loan balance as the base for risk sharing payments could help address some of the drawbacks of the SNRI metric (see page 6). Specifically, it helps ensure that preventing student loan default remains a key focus for schools, in addition to helping borrowers pay down their loan balance.

Calculating Risk Sharing Payments

Defaulted loan balances by institution are not publically available. To approximate a school's defaulted loan balance, we multiplied each school's median debt upon entering repayment by the number of students who entered default in the CDR cohort (the CDR numerator). To determine the payment amount for each school, we then multiply this estimation by the assessment rate determined by the school's SDRI or SNRI (assessment rates range from 5% to 14%).¹⁸ The table below shows the number of schools assessed a payment, and the total and average payment amounts using SDRI and SNRI. If schools did not improve, our proposal would generate about \$200 million in payments annually.

Summary of Risk Sharing Payments

	Using SDRI	Using SNRI
Percent of Schools Assessed Payment	17%	17%
Total Payments (rounded to nearest \$100,000)	\$173,900,000	\$192,500,000
Average Payment (rounded to nearest \$10,000)	\$230,000	\$280,000

The table below shows the share of schools making risk sharing payments at each assessment rate. Under both SDRI and SNRI, schools subject to risk sharing payments are concentrated at the lower end of the assessment range: over half of schools required to make a risk sharing payment fall into the lowest four assessment rates (60% using SDRI, and 55% using SNRI).

Share of Schools Required to Make Payments at Each Risk Level

SDRI Range	SNRI Range	Assessment Rate	Share of Schools Making Payments Under SDRI	Share of Schools Making Payments Under SNRI
>=10 and <11	>=45 and <47.5	5%	18%	17%
>=11 and <12	>= 47.5 and <50	6%	16%	13%
>=12 and <13	>=50 and <52.5	7%	13%	13%
>=13 and <14	>=52.5 and <55	8%	13%	13%
>=14 and <15	>=55 and <57.5	9%	8%	11%
>=15 and <16	>=57.5 and <60	10%	9%	8%
>=16 and <17	>=60 and <62.5	11%	8%	8%
>=17 and <18	>=62.5 and <65	12%	7%	7%
>=18 and <19	>= 65 and <67.5	13%	5%	5%
>=19 and <20	>=67.5 and <70	14%	3%	6%
			100%	100%

The same assessment rate will lead to larger or smaller payments depending on the size of the defaulted loan volume to which it is applied, and higher risk schools will pay a higher share of the defaulted loan volume.

¹⁸ A minimum payment amount, such as \$5,000 could also be established.

The table below shows the estimated total payments (rounded to nearest \$100,000) and share of payment amount by sector.

School Type	Using SDRI		Using SNRI	
	Risk Sharing Payments	% of Total Payments	Risk Sharing Payments	% of Total Payments
For-profit	\$110,700,000	64%	\$147,500,000	77%
Nonprofit	\$23,700,000	14%	\$23,300,000	12%
4-Year Public	\$15,600,000	9%	\$17,000,000	9%
2-Year Public	\$23,800,000	14%	\$4,700,000	2%
Total	\$173,900,000	100%	\$192,500,000	100%

Historically Black Colleges and Universities (HBCUs) Fund

The first Historically Black Colleges and Universities (HBCUs) were established as private schools to educate freed slaves. Later, states responded to the second Morrill Land-Grant Act in 1890 by creating public, segregated institutions.¹⁹ Operating in this unique space, and subject to persistent underfunding at both the state and federal levels, HBCUs continue to be recognized and respected for their historic and ongoing importance and accomplishments.

Available data show that, under our proposal, without improvement in student outcomes between now and the final year of implementation, more than half of HBCUs would be subject to risk sharing payments, and about one-fifth would lose Title IV eligibility. In recognition of historic funding and other inequities faced by these institutions, we propose new, temporary funding to provide them with additional resources specifically dedicated to improving student outcomes. Mandatory funding of \$100 million per year for eight years, beginning in the first year of implementation of the new accountability system, would provide significant new funding to HBCUs for the three years before any college is required to make risk sharing payments, and for five years afterward. Based on available data, all HBCUs would receive funds in excess of the required risk sharing payments, providing them with additional resources regardless of whether they are subject to risk sharing. However, as schools lower their risk over the course of the grant period, they will be able to use more, or all, of the additional funding to continue to improve student outcomes.

Phased Implementation: Setting Colleges Up for Success

Schools should be given time to adjust to a new accountability structure, to prepare and improve measured outcomes before they are sanctioned based on either the SDRI or SNRI. As a first step, schools already serving students well should be immediately rewarded to encourage greater enrollment of low-income students, innovation, and further improvements in student outcomes, and continued participation in the federal loan program. We also recommend immediately requiring risk-reduction plans for schools with current risk levels that, if unchanged, would result in risk sharing payments or eligibility loss once the system is fully implemented. These schools would have three years to improve before being subject to sanctions. The risk reduction plans create a framework that can help high-risk schools improve student outcomes and avoid being subject to more severe consequences, and also provide a lower-stakes yet meaningful consequence for schools that need improvement. Triggers for the

¹⁹ Freeman, Samara. 2015. *The History of HBCUs in America*. American RadioWorks. <http://www.americanradioworks.org/segments/hbcu-history/>. Accessed December 6, 2016.

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most extreme consequence, eligibility loss, would not be changed from current CDR thresholds until the fourth year of implementation.

The table below details the phased implementation schedule, listing the metric and threshold that would trigger each outcome at each year of implementation.

Proposed Implementation Schedule

Year of Implementation	Outcome			
	Rewards	Risk-Reduction Plan	Risk Sharing Payment	Eligibility Loss
Year 0 (current policy)	None	CDR>=30 for one year	None	CDR>=30 for three years ²⁰
Year 1	SDRI <=5 or SNRI <=30	SDRI>=10 or SNRI>=45	None	CDR>=30 for three years
Year 2	SDRI <=5 or SNRI <=30	SDRI>=10 or SNRI>=45	None	CDR>=30 for three years
Year 3	SDRI <=5 or SNRI <=30	SDRI>=10 or SNRI>=45	None	CDR>=30 for three years
Year 4 and beyond	SDRI <=5 or SNRI <=30	SDRI>=10 or SNRI>=45	SDRI>=10 and <20 or SNRI>=45 and <70	SDRI>=30 or SNRI >=70

Conclusion

Colleges need to have a greater stake in their students' success and ability to repay their debts. Using a debt outcome metric that accounts for the share of students who borrow at each college to assess college performance would be a clear improvement on the existing CDR accountability standards, which measure risk only for borrowers at an institution. Our proposed federal college accountability system, to be applied without exemption to all Title IV colleges, uses scaled risk sharing payments to create "skin in the game" for high-risk colleges, and uses financial and nonfinancial rewards to encourage all schools to improve and enable schools serving their students well to enroll more low-income students. This proposal reflects our fundamental belief that an accountability system must combine sanctions and rewards in order to best align incentives that enhance student outcomes and reduce risk to taxpayers.

²⁰ Or over 40% in one year.