PRESENTED BY: Jeff Arthur

The economy is in a slump and there aren't many good signs right now for most businesses...So , I believe we should all be thankful we are in an industry that appears to be bucking that trend. We have a bright future in an industry that is capable of great success regardless of the state of the economy. But we must manage our risks or we could find our individual colleges with great short term success, but no future.

In my estimation, we face 2 very serious risks, and a few other minor ones.

What do you all think are some risks we face? (90/10...was this solved by congress this week? No! we have a period to adapt, but we better start adapting because it could be VERY tough when this grace period wears off, and we may really trick ourselves with this temporary transition period)

Default for many will be the biggest risk, and by the end of this session, I think you will understand why! Limited Financial Assistance. Got a nice increase that will help, for some it will outweigh the loss of free money (sub prime / opp pools). State and federal regulation.

I attended this leadership institute in 1992. At that time, default rates were the biggest risk facing our industry. Many colleges didn't figure it out and were closed down. But in the early 90s we figured out the rules for default, and basically made this a functional area of the college and for most of us became something we thought about twice per year. When our draft default rates came out in April, and our final rates in September...We high-five each other, brag about how great we are for a few minutes, then focus on the other operations of the business.

I think it will helpful to look at the history of student loan default rates. When it was decided to publish default rates, most career colleges got letters saying their default rate was 25-50%! This was in the late 80s/early 90s. In 1992 institutions with over 25% for 3 years were closed, or one year over 40%. There actually were hundreds of colleges put out of business due to high default rates.

But the DOE and pretty much everyone wanted to show the great progress being made to reduce defaults, so they changed the formula to indicate a student was in default after being 270 days delinquent on their student loan instead of 180 days. Administratively, you could also 'cure' your default during the claims process, which could take up to another 60 days. The result of this formula change, and additional effort by schools/lenders/guarantors, had everyone beating their chest that the problem was solved as default rates continued to decline for 15 years.

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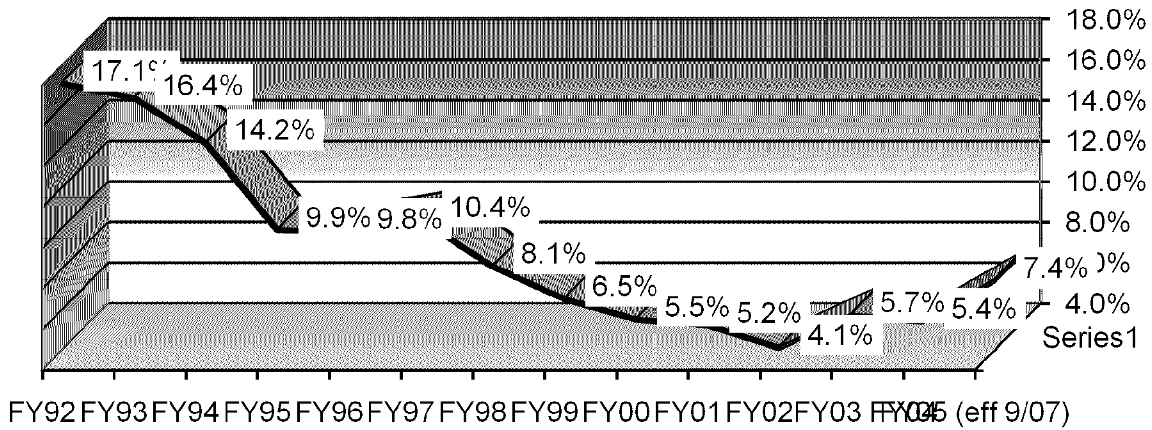
ECPI COLLEGE OF TECHNOLOGY
Default Rate Trend



Here is the formula currently in use to calculate default rates, but don't ask me to defend the formula or suggest it is an accurate business model, it is just the formula that congress decided on and the rules we must live by.

INSERT FORMULA CHART

So, what do we have to do to keep someone out of default? On average, we only have to get students to pay or forbear their loans for 6 months! With the proper effort, it really isn't that hard to keep your default rate low!

Much is talked about what default rates mean. Well, the rates determined from this formula tell us a few things, but not much. They are intended to measure the quality of an institution and whether it is worthy of taxpayer investment in students attending there. LOL

In reality, they can tell us that a college is doing a good job of following up to make sure their former students follow a few simple steps to stay out of default…just for a while, then we don't care. They also are a reflection of the socioeconomic risks of the population an institution serves. If they really wanted to accurately measure quality or effectiveness of taxpayer investment, they would regulate based on graduation rates, employment rates, and starting salaries. But that doesn't' work because if they did, career colleges would be the only ones standing!!!!

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Guarantors and lenders are not stupid though; they have their own calculations and ways to evaluate risk. They may pretend to look at your published default rate, but the fact is there was great profit in student loans that meant they didn't have to care too much. But I assure you; REAL, dollar-based, lifetime default calculations are being done now, and are a factor in decisions to give your students access to FFEL and private loans! It doesn't matter the worthiness of taxpayer investment, profit is what matters.

So, given that default rates have declined, and we as a sector have basically conquered the issue of default rates…WHY am I saying default rates are one of the two biggest risks we face? Can someone tell me what has changed that?

YES! I recall hearing the next morning that on a Wednesday evening, I believe it was, a congressman had added an amendment to a bill at the last second that would change the formula for measuring default rates. It sounded logical enough, and relatively harmless. After all if the national default rate was around 5% and we hear that the current cohort period doesn't allow much time for default, that by just adding one more year to an already 2 year cohort period would give a more accurate default rate….makes sense!

I happen to think this was carefully orchestrated and supported through ACE and maybe a few other trade organizations as a way to slow down career colleges. I was invited to a meeting with DOE officials from the default management division a little over a year ago, and along with 9 other large career colleges, was told they felt that defaults were going to receive increased attention, and we should be taking some steps to admit more qualified students to our institutions in order to lower default rates. Well, it seemed to come out of left field, but I suspect they were receiving inquiries about default rates at career colleges, and this was carefully orchestrated plan to make a change without giving us a chance to fight it. CCA and career colleges have been successful in lessening the penalties for higher default rates, for which we should be grateful. But don't kid yourself, even if your default rate doesn't get to the now 30% threshold where penalties can be applied, the battle can be lost long before that as consumers, legislators, PRESS, all do plenty of damage by declaring how horrible your 20% default rate is and an errant formula has been hiding the fact for years that your students are not successful because huge numbers of them default on their student loans.

WE MUST ACT NOW TO LOWER THEM because the first students that will be in first couple of years are already IN your school, and the first cohort under this formula has just left your college starting this April!

SO what is the new formula, and why is it so serious.

INSERT NEW FORMULA AND EFFECTIVE DATE

As you can see, the 'opportunity window for default' has not increased just 50% from 2 to three years, but as much as 150% from 6 months on average to 18 months on average! At the same time, lenders could become less gracious in granting forberances and cooperating in general to do extra work beyond what due diligence is required to prevent defaults. Guarantors whose job it is to prevent and then recovered defaulted loans are under fire some as well, and I fully expect the currently 18 guarantors out there will pare down to 7 or 8 over the next few years. Plus research has shown that students being serviced in the direct loan program are more likely to default, and we know there will be big increases, maybe really big increases, in the use of DL. The effects of the new formula will be much more significant on career colleges as well, because we all know that we do much more work than other colleges in getting our default rates low, so when most of us have ended that work at the end of the cohort period, when you go beyond the cohort period, the rates are likely to skyrocket. I have had analysis from our guarantor, and informally from the Dept as Ed as they won't say anything official, that the rates are going to be around 2.5 x greater than the current cohort rate, and I think some colleges may see 4x or more in some cases. You can imagine how that will play in your local newspaper when they do a story on the default rates of institutions in your city! Now is everyone getting a sense of why this topic is on your agenda!

So what can we do to lower our default rates? I will show you some of the things we have done, or have in the works to implement at our college. Also, if your college outsources DM, I would be asking your DM servicer whether they are already extending the period to track defaults.

INSERT SLIDES FROM CCA PRESENTATION.