Exhibit 3

Information/Action Item

Update on CDR manipulation issue

As authorized by the Commission at the November 21-22, 2013 meeting, an ad hoc committee of Commissioners Nancy Anton and Michele Siqueiros drafted, and Chair McDowell approved and signed, a letter to Arne Duncan, Secretary, United States Department of Education (USED), urging USED to use the upcoming program integrity negotiated rulemaking sessions scheduled for February, March, and April of 2014 to strengthen rules related to cohort default rate (CDR) manipulation, and requesting data relating to CDR manipulation for California institutions. The letter is attached as Exhibit 3.1.

Commission staff will continue to work with partners, including The Institute for College Access and Success (TICAS), to achieve meaningful preventive action at the federal level.

State action, however, may also be appropriate. The California State Treasurer's Office has recently reported that delinquencies on both government and private student loans were higher in California than in the U.S. as a whole. As of the fourth quarter of 2012, 17.7 percent of California's student loans – including both government and private loans – were delinquent for at least 90 days according to the California Education Facilities Authority (CEFA) within the State Treasurer's Office.[1] The U.S. rate was 17.3 percent.

CEFA reported that California's average student loan balance in the fourth quarter of 2012, including government and private loans, was $25,700, slightly higher than the U.S. average of $24,800. Total outstanding student loan debt in California amounted to $97 billion, nearly matching the $98.5 billion of General Fund appropriations in the 2012-13 state budget. Further, approximately 10 percent of Californians, about 3.8 million people, carried student loan debt burdens, and of that total, about 1.2 million student loan debtors were over 40 years old.[2]

Commission staff has learned that legislative proposals related to CDR manipulation may be introduced during this portion of the legislative session. We will bring recommendations to the Commission after reviewing the relevant bills.

Responsible Person(s): Ed Emerson, Chief
Strategic Policy, Media and Communications Division

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[1] California State Treasurer's Office, *The Weekly Briefing 2/3/2014*, pp. 3-4.
[2] *Ibid.*

STATE OF CALIFORNIA
CALIFORNIA STUDENT AID COMMISSION

January 23, 2014

The Honorable Arne Duncan
Secretary of Education
U.S. Department of Education
LBJ Building, Room 7W301, Mail Stop 0100
400 Maryland Avenue, SW
Washington, D.C. 20202

Dear Mr. Duncan,

Since 1955, the California Student Aid Commission (Commission) has operated as the principal state agency responsible for administering financial aid programs for students attending public and private universities, colleges and vocational schools in California. The Commission's central mission is to make education beyond high school financially accessible to all Californians, and it provides financial aid policy analysis and leadership, in partnership with California's colleges, universities, financial institutions, and financial aid associations. In total, the Commission provides over $1.6 billion annually in state general fund supported financial aid grants to over 285,000 California college students through a variety of programs.

We are writing for two reasons: (1) to urge the U.S. Department of Education to use the upcoming program integrity negotiated rulemaking sessions scheduled for February, March, and April of 2014 to strengthen rules related to cohort default rate (CDR) manipulation and (2) to request data for California institutions as relates to CDR manipulation.

Background. The state of California relies upon the Department of Education's calculations of postsecondary institutions' cohort default rates (CDRs) for the purpose of administering its primary student grant aid program, the Ortiz-Pacheco-Poochigian-Vasconcellos Cal Grant Program, commonly known as the Cal Grant Program(s). Similar to the federal government, California believes this requirement aids in holding colleges accountable for the taxpayer funding they receive, and helps target available financial aid resources to the colleges where students will be better served.

Since 2011, in addition to other longstanding eligibility criteria, California has limited institutional participation in the Cal Grant Program by setting minimum student outcome standards. Currently, colleges that have more than 40 percent of their undergraduates who take out federal student loans must meet two new eligibility criteria: the college must maintain a three-year cohort default rate below 15.5 percent and a graduation rate above 30 percent. Please note that the 15.5-percent cohort default rate adopted by California is more stringent than the 30-percent federal cohort default rate.

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Only institutions that meet both the maximum default rate and minimum graduation rate may receive eligible students' Cal Grant aid. The Commission is required by California statute to certify in October of each year which institutions met these thresholds (based on their most recent graduation rates and three-year CDR) and, consequently, are eligible to participate in the Cal Grant program for the upcoming academic year. Our most recent list of institutions eligible for the 2014-15 academic year includes 305 colleges across the state. Of these, 16 were ineligible for Cal Grants for the 2013-14 academic year because they failed to meet the 15.5-percent CDR requirement, but regained eligibility for the 2014-15 year due to decreases in their most recent CDR. Two additional colleges were ineligible in 2013-14 because they failed to meet both the CDR and graduation-rate requirements, but regained eligibility in 2014-15.

Naturally, decreases in the number of borrowers defaulting are to be applauded. However, in some cases, CDR decreases may signify aggressive actions being taken to keep CDRs low, and say little or nothing about improved student outcomes. We are particularly concerned about possible inappropriate use of two such actions: forbearance and campus reorganization. Since CDRs measure defaults during a three-year period of time, it has been well documented that some colleges use forbearance to help students avoid default during the measured period, only to experience sharp spikes in the share of borrowers defaulting after the three-year period ends. Similarly, by consolidating multiple campuses into one entity for federal aid purposes, some colleges evade oversight by using their low- or moderate-CDR campuses to mask their poorly performing campuses, which allows all of the campuses to remain eligible for aid.

While avoiding default is always in students' best interest, increasing their loan balance and leaving them to default on a higher balance is not. Loans always accrue interest while in forbearance, and unsubsidized loans accrue interest during both forbearances and deferments. The additional interest accrued is added to the principal loan balance at the end of the forbearance or deferment, with the result that interest then begins accruing on an even larger balance. In most cases, students struggling to make loan payments are better served with counseling on how to repay their loans and the availability of Income-Based Repayment (IBR) rather than with forbearance.

Our Request to You: As we testified in San Francisco on May 30, 2013 at your hearing on suggested topics for negotiated rule making, we are concerned about colleges' evasion of oversight – both federal and state – by manipulating their CDRs to fall under required thresholds. Further, the Commission's inability to determine which CDRs reflect manipulation undermines the integrity of the Cal Grant programs. Therefore, as administrators of the largest state grant program in the nation, with authorized disbursements of over $1.6 billion in aid in the 2013-14 year, we make the following two requests of the Department:

1. Take the following actions, along with any others the Department deems warranted, to curb CDR manipulation during the upcoming program integrity negotiations scheduled to begin in February:

    a. Define what it means for a forbearance to be "for the benefit of the student borrower", as required by the Higher Education Act. The Department could, for instance, specify that certain types of forbearance patterns are rarely to borrowers' benefit and prohibit back-to-back forbearances. Alternatively, the Department could require documentation for why IBR is not preferable to forbearance before an extended forbearance is granted. Each of these rule modifications recognizes the importance of forbearance as shortterm relief but prioritizes longer-term solutions – such as affordable repayment plans – for the longer term.

b. Prohibit schools/servicers from making any payments to get students into forbearance. In investigating forbearance abuse, the Department itself found one borrower who had been given a gift card to get into forbearance after previously being in good standing on her loan.

c. Prohibit changes in OPEIDs in cases where institutional compliance is in question or require continued compliance under former OPEIDs for at least three years after any change in OPEID and sanction any that would have exceeded the CDR thresholds but for the change in OPEID.

2. Provide data to California to illuminate the extent of the abuse and, in light of the abuse, potential alternative measures for the state of California to use in assessing institutional eligibility:

   a. The extent of the CDR manipulation at California colleges:

      i. Data on the reliance of former students on forbearance. Example: For the last three CDR cohorts, how many and what share of students in each college's cohort were in forbearance at the end of the CDR window?

      ii. Information about any California colleges that have consolidated campuses (OPEIDs) in recent years, along with CDRs calculated both as consolidated and as separated.

      iii. A list of colleges that have appealed any of their last three CDRs, along with the basis for the appeals.

   b. Potential alternative measures for California to use in assessing institutional eligibility for Cal Grants:

      i. Custom calculations of CDRs for California colleges to see how sharply CDRs increase at individual colleges after the three-year window of time has ended. Colleges that artificially keep defaults down using forbearance tactics may show large jumps when a longer window of time than the standard measure is considered, since the college will have stopped "managing" their defaults.

      ii. College repayment rates, as defined in the Smarter Borrowing Act (S. 546, 113th Congress). Whereas CDRs show how many borrowers have failed to make payments on their loans for an extended period of time, repayment rates show whether borrowers are successfully paying down their debt.

      iii. For each college, the number of borrowers in their FY10 cohort who made six or fewer payments before the end of FY12 but did not default. Like the repayment rate data, this would shed light on how many borrowers were able to consistently make payments on their loans, rather than just their inability to make hardly any payments as CDRs show.

We thank you for your attention to this issue and welcome the opportunity to work with you on improving the oversight of federal and state financial aid investments. Please contact Executive Director Diana Fuentes-Michel at 916-464-8271 with questions or to follow up.

Sincerely,

John R. McDowell, Jr.
Chairman

CC: James W. Runcie, Chief Operating Officer, Federal Student Aid, U.S. Department of Education