

**DEPARTMENT OF EDUCATION****34 CFR Part 682**

RIN 1840-AC78

**Federal Family Education Loan (FFEL) Program**

AGENCY: Department of Education.

ACTION: Notice of proposed rulemaking.

**SUMMARY:** The Secretary proposes to amend the Federal Family Education Loan (FFEL) Program regulations. These proposed regulations implement changes made to the Higher Education Act of 1965 by the Higher Education Amendments of 1998 (the "1998 Amendments"). The proposed regulations cover a variety of items, including changes to the financial structure of guaranty agencies in the FFEL Program.

**DATES:** We must receive your comments on or before September 15, 1999.

**ADDRESSES:** Address all comments about these proposed regulations to Ms. Pamela A. Moran, U.S. Department of Education, P.O. Box 23272, Washington, DC 20202-5449. If you prefer to send your comments through the Internet, use the following address: [ffelnprm@ed.gov](mailto:ffelnprm@ed.gov)

If you want to comment on the information collection requirements, you must send your comments to the Office of Management and Budget at the address listed in the Paperwork Reduction Act section of this preamble. You may also send a copy of these comments to the Department representative named in this section.

**FOR FURTHER INFORMATION CONTACT:** Mr. George Harris, U.S. Department of Education, 400 Maryland Avenue, SW., room 3045, ROB-3, Washington, DC 20202-5449. Telephone: (202) 708-8242. If you use a telecommunications device for the deaf (TDD) you may call the Federal Information Relay Service (FIRS) at 1-800-877-8339.

Individuals with disabilities may obtain this document in an alternate format (e.g., Braille, large print, audiotape, or computer diskette) on request to the contact person listed in the preceding paragraph.

**SUPPLEMENTARY INFORMATION:****Invitation to Comment**

We invite you to submit comments regarding these proposed regulations. To ensure that your comments have maximum effect in developing the final regulations, we urge you to identify clearly the specific section or sections of the proposed regulations that each of your comments addresses and to arrange

your comments in the same order as the proposed regulations.

We invite you to assist us in complying with the specific requirements of Executive Order 12866 and its overall requirement of reducing regulatory burden that might result from these proposed regulations. Please let us know of any further opportunities we should take to reduce potential costs or increase potential benefits while preserving the effective and efficient administration of the program.

During and after the comment period, you may inspect all public comments about these proposed regulations in Room 3045, ROB-3, 7th and D Streets, SW., Washington, DC, between the hours of 8:30 a.m. and 4:00 p.m., Eastern time, Monday through Friday of each week except Federal holidays.

**Assistance to Individuals With Disabilities in Reviewing the Rulemaking Record**

On request, we will supply an appropriate aid, such as a reader or print magnifier, to an individual with a disability who needs assistance to review the comments or other documents in the public rulemaking record for these proposed regulations. If you want to schedule an appointment for this type of aid, you may call (202) 205-8113 or (202) 260-9895. If you use a TDD, you may call the Federal Information Relay Service at 1-800-877-8339.

**Background**

These proposed regulations are needed to implement and reflect changes to the Higher Education Act of 1965 (the HEA) made by the 1998 Amendments, Public Law 105-244, enacted October 7, 1998.

The FFEL Program regulations (34 CFR part 682) govern the Federal Stafford Loan Program (subsidized and unsubsidized), the Federal Supplemental Loans for Students Program (no longer active), the Federal PLUS Program, and the Federal Consolidation Loan Program (formerly collectively known as the Guaranteed Student Loan Programs). A lender that is eligible under the HEA may make guaranteed loans under the FFEL Program. A guaranty agency is a State or private nonprofit entity that has an agreement with the Secretary to perform certain administrative roles in the FFEL Program. Guaranty agencies receive and hold Federal funds to pay certain FFEL Program costs and expenses. They are trustees for the Federal Government and must comply with fiduciary standards.

**Negotiated Rulemaking Process**

Section 492 of the HEA requires that, before publishing any proposed regulations to implement programs under Title IV of the HEA, the Secretary obtain public involvement in the development of the proposed regulations. After obtaining advice and recommendations, the Secretary must conduct a negotiated rulemaking process to develop proposed regulations. All published proposed regulations must conform to agreements resulting from the negotiated rulemaking process unless the Secretary reopens the negotiated rulemaking process or provides a written explanation to the participants in that process why the Secretary has decided to depart from the agreements.

To obtain public involvement in the development of the proposed regulations, the Secretary published a notice in the **Federal Register** (63 FR 59922, November 6, 1998) requesting advice and recommendations from interested parties concerning what regulations were necessary to implement Title IV of the HEA. We also invited advice and recommendations concerning which regulated issues should be subjected to a negotiated rulemaking process. We further requested advice and recommendations concerning ways to prioritize the numerous issues in Title IV, in order to meet statutory deadlines. Additionally, we requested advice and recommendations concerning how to conduct the negotiated rulemaking process, given the time available and the number of regulations that needed to be developed.

In addition to soliciting written comments, we held three public hearings and several informal meetings to give interested parties an opportunity to share advice and recommendations with the Department. The hearings were held in Washington, DC, Chicago, and Los Angeles, and we posted transcripts of those hearings to the Department's Information for Financial Aid Professionals website (<http://www.ifap.ed.gov>).

We then published a second notice in the **Federal Register** (63 FR 71206, December 23, 1998) to announce the Department's intention to establish four negotiated rulemaking committees to draft proposed regulations implementing Title IV of the HEA. The notice announced the organizations or groups believed to represent the interests that should participate in the negotiated rulemaking process and announced that the Department would select participants for the process from

nominees of those organizations or groups. We requested nominations for additional participants from anyone who believed that the organizations or groups listed did not adequately represent the list of interests outlined in section 492 of the HEA. Once the four committees were established, they met to develop proposed regulations over the course of several months, beginning in January.

The proposed regulations contained in this notice of proposed rulemaking (NPRM) reflect the final consensus of the negotiating committee, which was made up of the following members:

- American Association of Collegiate Registrars and Admissions Officers.
- American Association of State Colleges and Universities.
- American Council on Education.
- Career College Association.
- Consumer Bankers Association.
- Education Finance Council.
- Education Loan Management Resources.
- Guaranty Agency CEO Caucus.
- Legal Services Counsel (a coalition).
- National Association of Independent Colleges and Universities.
- National Association of State Student Grant and Aid Programs.
- National Association of State Universities and Land Grant Colleges.
- National Association of Student Financial Aid Administrators.
- National Association of Student Loan Administrators.
- National Council of Higher Education Loan Programs.
- National Direct Student Loan Coalition.
- Sallie Mae, Inc.
- State Higher Education Executive Officers Association.
- Student Loan Servicing Alliance.
- United States Department of Education.
- United States Student Association.
- US Public Interest Research Group.

As stated in the committee protocols, consensus means that there must be no dissent by any member in order for the committee to be considered to have reached agreement. Consensus was reached on all of the proposed regulations in this document.

The committee that developed these proposed regulations focused on issues unique to FFEL Program guaranty agencies and lenders, particularly in the areas where changes were made to the HEA by the 1998 Amendments affecting guaranty agency financial restructuring. Issues that affected Title IV borrowers in general, such as deferments, cancellations, forbearances, loan amounts, interest rates, etc., were

addressed by another negotiating committee. However, the committee agreed that if it completed its required work early, the negotiators could propose changes to update or clarify other provisions in the existing FFEL regulations that were not otherwise being modified as a result of the 1998 Amendments. The committee reached consensus on its required work early and, in response to proposals presented by various negotiators, spent most of its last meeting looking at changes to other regulatory provisions. Some of those additional changes were agreed to by the committee and are included in these proposed regulations.

The goal of the negotiations was to develop an NPRM that reflected a final consensus of the negotiating committee. The proposed regulations in this document reflect that consensus. The following discussion includes summaries of some of the points of view expressed by the negotiators as they sought to reach consensus. This information will assist you in understanding the rationale for some of these proposed regulations.

The members of the committee represented lenders, loan servicers, guaranty agencies, schools, students, and other interested parties from various sectors of the FFEL Program and student aid community, as well as the Secretary. We listened to the views and recommendations offered by the other negotiators during the first meeting of the committee on January 19–20, 1999, and prepared draft proposed regulations that were provided to the other negotiators on February 12. The committee discussed these draft regulations at the second meeting on February 16–17. Taking into account the information provided at the February meeting, we revised the draft proposed regulations and provided them to the other negotiators on March 18. The committee discussed the revised draft regulations during the third meeting on March 22–24, and tentative agreement was reached on many issues.

Between the third and fourth meetings, we again revised the draft proposed regulations and provided them to the other negotiators on April 15. The negotiators discussed the revised draft regulations at the fourth meeting, on April 19–20, and tentative agreement was reached on the entire draft regulations, subject to the edits agreed to by the negotiators. Those edits were incorporated into a new draft, which the Department sent to the other negotiators on May 10. The last meeting of the negotiated rulemaking committee was held May 17–18. On May 17, after a few refinements to the draft language,

the negotiators agreed to the draft proposed regulations that they had developed without dissent. After reaching consensus on the regulations that were required to be developed as a result of the 1998 Amendments, the negotiators then agreed to examine other existing regulations that some negotiators believed should be modified. The following discussion of the proposed regulations covers both sets of regulations: the regulations required to implement the changes made to the HEA by the 1998 Amendments and other regulations that the negotiators agreed to propose or revise.

### Proposed Regulatory Changes

In accordance with the consensus reached in the negotiated rulemaking, the Secretary proposes to amend the following sections of the regulations:

#### *Section 682.205 Disclosure Requirements for Lenders*

The proposed regulations would implement the changes made by the 1998 Amendments to section 433 of the HEA. Those changes affect the loan disclosures that a lender is required to provide to a borrower. Specifically, the HEA now requires a lender to use simple and understandable terms in its disclosure statements and to provide a telephone number the borrower can use to obtain additional loan information. The changes to the HEA also permit a lender to provide the disclosure information and the lender's phone number electronically.

The negotiators reached consensus on these proposed regulations and enhanced the telephone number requirement by requiring the lender to provide a toll free number accessible within the United States.

#### *Section 682.207 Due Diligence in Disbursing a Loan*

Although the proposed regulations in this section do not implement changes made by the 1998 Amendments, the negotiators agreed to propose them as improvements to the existing FFEL Program regulations.

The negotiators agreed to propose a change to the Secretary's longstanding policy that a lender must cancel all future disbursements on a loan whenever the first disbursement is returned to the lender. Some negotiators argued that this policy encouraged borrowers to accept loan funds they did not need at the beginning of a school year. Under current policy, a borrower who realizes he or she does not need the first disbursement of a loan and returns the unneeded funds to the lender is

required to reapply later in the year to obtain subsequent disbursements that he or she does need. The extra paperwork and loan processing creates an unnecessary burden on the borrower, the school, the lender, and the guaranty agency. The proposed regulations would leave in place the provision that when a disbursement is returned because the student withdrew, the remaining disbursements are cancelled. However, under the proposed regulations, in the absence of information that the student is no longer enrolled, and at the request of the school, a lender may disburse subsequent disbursements after the first disbursement is returned to the lender.

#### *Section 682.208 Due Diligence in Servicing a Loan*

The proposed regulations would make changes to reflect the establishment of a Student Loan Ombudsman's office in the Department, as provided by section 141(f) of the 1998 Amendments. The Ombudsman's office would provide informal resolution of complaints received from Title IV loan borrowers.

The negotiators agreed that the FFEL Program regulations should require schools, lenders, and guaranty agencies to inform borrowers of the existence of the Department's Student Loan Ombudsman's office to resolve disputes borrowers have regarding their FFEL Program loans. The negotiators believed that a borrower should first try to resolve any dispute with a lender or loan servicer on the assumption that many of these disputes are simple misunderstandings. However, if the borrower informs the lender or servicer in writing that he or she believes the dispute has not been resolved, the lender or servicer would advise the borrower to request the guaranty agency to settle the dispute. The guaranty agency analyzes the information provided by the borrower and other parties and notifies the borrower of its decision. If the guaranty agency does not resolve the dispute, the agency's response must provide the borrower with information about the Department's Student Loan Ombudsman's office. The negotiators believed this process would resolve the vast majority of disputes.

In addition to inserting this requirement in § 682.208, the negotiators also proposed adding a conforming requirement to § 682.411 so that the lender due diligence regulations would also contain an Ombudsman notification provision. In addition, guaranty agencies would be required to inform defaulted borrowers of the availability of the Department's Student Loan Ombudsman's office. The

negotiators believed this notice to a student loan defaulter would be most effective if it was part of the notification already required by § 682.410(b)(5) before a guaranty agency reports the borrower's default to a credit bureau. Finally, although not part of the proposed regulations developed by this negotiating committee, another negotiating committee agreed to propose regulations requiring schools to provide information about the Department's Student Loan Ombudsman's office when providing exit counseling to borrowers.

#### *Section 682.210 Deferment*

Although the proposed regulations in this section do not implement changes made by the 1998 Amendments, the negotiators agreed to propose them as improvements to the existing FFEL Program regulations.

These regulations propose to exclude in-school deferments from the general requirement that a deferment may not be granted for a period beginning more than 6 months before the date the lender receives the request and the documentation required for the deferment. The negotiators believed that the process for obtaining documentation to support an in-school deferment is almost always beyond the student's ability to control. Moreover, many students mistakenly assume that the school notifies their lender that they are in-school. Taken together, these factors have resulted in misunderstandings and technical problems that have led to borrowers defaulting while they are enrolled in-school and eligible for an in-school deferment.

#### *Section 682.211 Forbearance*

Although the proposed regulations in this section do not implement changes made by the 1998 Amendments, the negotiators agreed to propose them as improvements to the existing FFEL Program regulations.

The proposed regulations would modify and incorporate into the regulations the Secretary's policy of permitting lenders and guaranty agencies to grant administrative forbearances to assist FFEL borrowers who are residents of areas where natural disasters have occurred. Under that policy, the Secretary notifies loan holders whenever the Federal Emergency Management Agency (FEMA) designates an area eligible for Federal assistance under FEMA's Individual Assistance Program. The Secretary strongly recommends that loan holders grant forbearances to borrowers who contact them and indicate that they have been adversely

affected by a natural disaster and need temporary relief from their loan obligations. If the holder believes that the borrower has been harmed and needs assistance, the holder may grant a forbearance for up to 3-months based on the borrower's oral or written request for assistance, which must be documented in the holder's files. The holder does not need to obtain supporting documentation or a signed written agreement from the borrower to justify a forbearance for this initial 3-month period. However, a continuation of the forbearance past this 3-month period would require supporting documentation and a written agreement from the borrower.

The proposed regulations would modify that policy by allowing loan holders to determine if a natural disaster had occurred that affected the borrower's ability to make payments on the loan. If the holder made that determination, it could grant an administrative forbearance to the borrower for up to 3 months consistent with the Secretary's previously described policy. The determination of whether a borrower is covered by a natural disaster would be made by the loan holder, with no requirement that the disaster area be covered under FEMA's Individual Assistance Program. Because loan holders would decide whether a borrower is covered by a natural disaster, the Secretary would no longer need to notify loan holders about the numerous disaster areas designated by FEMA each year. In addition, the forbearance would not be limited only to residents of the disaster area, but could include, at the holder's discretion, borrowers who were adversely affected by the disaster even if they lived outside the disaster area. For example, if the county where the borrower resides suffers no actual damage from tornadoes that destroy the borrower's place of employment in an adjoining county, the forbearance would be permitted. Under the proposed regulations, the determination of whether the borrower was affected by a natural disaster would be made by the holder of the loan, and the Secretary would not challenge a holder's reasonable exercise of that judgment.

The proposed regulations would also allow a lender to grant an administrative forbearance to resolve a borrower's delinquency that existed at the beginning of a mandatory administrative forbearance period under § 682.211(j)(2). These forbearances apply whenever the lender is notified by the Secretary that—

- Exceptional circumstances exist, such as a local or national emergency or military mobilization; or

- The geographic area in which the borrower or endorser resides has been designated as a disaster area by the President of the United States or Mexico, the Prime Minister of Canada, or a Governor of a State.

#### *Section 682.215 Federal Stafford Loan Forgiveness Demonstration Program*

The Federal Stafford Loan forgiveness demonstration program was established under section 428J of the HEA by the Higher Education Amendments of 1992. The loan forgiveness program was never implemented because funds were never appropriated for the program. With the enactment of the 1998 Amendments, the Federal Stafford Loan forgiveness demonstration program was replaced by a new section 428J titled "Loan forgiveness for teachers." Consequently, the regulations currently in § 682.215 for the Federal Stafford Loan forgiveness demonstration program are no longer needed and would be deleted.

#### *Section 682.302 Payment of Special Allowance on FFEL Loans*

The proposed regulations would implement the requirements of section 438(b)(2)(H) of the HEA, which modified the statutory formula for calculating the amount of special allowance payable on an FFEL Program loan. Previously, the general formula subtracted the applicable interest rate on the loan from the average of the 91-day Treasury bills auctioned during a quarter, and a special allowance factor of 3.1 percent was added to the result. That calculation produced an annualized special allowance rate, which was then divided by four to determine the special allowance paid to the lender for that quarter. The changes made by section 438(b)(2)(H) of the HEA reduced the special allowance factor from 3.1 percent to 2.8 percent, with a further reduction to 2.2 percent during the in-school, grace, and deferment periods. For example, under the new formula, if the 91-day Treasury bill average for a quarter was 5.4 percent and the applicable interest rate on a loan was 7.4 percent, the special allowance calculation for a loan in repayment and not in deferment would be:

$$(5.4 - 7.4) + 2.8 \div 4 = 0.2 \text{ percent}$$

In addition to reflecting the previously described revisions, these proposed regulations also reflect the changes made to the HEA relating to the special allowance calculation for loans made or purchased with the proceeds of tax-exempt funds. More specifically, these proposed regulations specify which loans qualify for the minimum

(or floor) special allowance rate and are subject to the 50 percent limitation on the maximum special allowance rate.

#### *Section 682.305 Procedures for Payment of Interest Benefits and Special Allowance and Collection of Origination and Loan Fees*

The proposed regulations would implement sections 438(c), 438(d), and 428(b)(1)(U)(iii)(I) of the HEA, requiring the Secretary to collect origination fees owed by a lender by offsetting the amount of interest and special allowance payments due the lender or by collecting the amount of origination fees directly from the lender.

Under the proposed regulations, if the full amount of origination and loan fees cannot be collected from the originating lender and the loan has been transferred to a subsequent holder, the Secretary may, following written notice, collect the fees from the subsequent holder. To ensure that originating lenders report origination and loan fees due the Secretary, the negotiators proposed that all participating lenders be required to submit a quarterly ED Form 799 (request for interest and special allowance), or comply with whatever successor process to the ED Form 799 may exist in the future. These proposed regulations would require lenders to report quarterly even if the lender is not owed, or does not wish to receive, interest benefits or special allowance payments from the Secretary.

#### *Section 682.400 Agreements Between a Guaranty Agency and the Secretary*

The proposed regulations would delete the reference to the payment of administrative cost allowances to guaranty agencies. Those allowances were eliminated by the 1998 Amendments.

#### *Section 682.401 Basic Program Agreement*

The proposed regulations would implement changes made by the 1998 Amendments to sections 422(c)(6)(B)(i) and 428(j)(3) of the HEA. The negotiators agreed to propose that guaranty agencies be required to receive and respond to written, electronic, and telephone inquiries.

A guaranty agency must ensure that it or an eligible lender as described in section 435(d)(1)(D) of the HEA serves as a lender-of-last-resort in the State in which the guaranty agency is the designated guaranty agency. The designated guaranty agency is the guaranty agency with which the Secretary has signed a Basic Program Agreement under § 682.401 to serve the State. The guaranty agency or the

lender-of-last-resort may arrange lender-of-last-resort loans to be made by another eligible lender. The proposed regulations specify which loans a lender-of-last-resort is required to make in order to satisfy its statutory obligation. In addition, the proposed regulations provide a lender-of-last-resort with authorization to expand its lender-of-last-resort program to borrowers other than those it is required to serve to meet its statutory obligation.

The proposed regulations describe the procedures that would be used by the Secretary to determine which guaranty agencies would receive Federal funds to be used to make lender-of-last-resort loans. A guaranty agency using Federal funds would be required to provide lender-of-last-resort subsidized and unsubsidized Federal Stafford loans and Federal PLUS loans to borrowers who are otherwise unable to obtain loans under the agency's lender-of-last-resort program. The funds would be advanced on terms and conditions agreed to by the Secretary and the agency if the Secretary determines that—

- Eligible borrowers in a State who qualify for subsidized Federal Stafford loans are seeking and are unable to obtain subsidized Federal Stafford loans;
- The guaranty agency designated for that State has the capability to provide lender-of-last-resort loans in a timely manner, either directly or indirectly using a third party, but cannot do so without Federal capital; and
- It would be cost effective to advance Federal funds to the agency.

The Secretary may provide Federal funds to another guaranty agency, other than the designated agency, to serve a State if the Secretary determines that the designated guaranty agency does not have the capability to provide lender-of-last-resort loans in a timely manner or that it would not be cost effective to provide Federal funds to the designated agency.

In the area of prohibited inducements, the proposed regulations prohibit a guaranty agency from mailing or otherwise distributing unsolicited loan applications to students enrolled in a secondary school or a postsecondary institution, or to parents of those students, unless the potential borrower has previously received loans insured by the guaranty agency.

The negotiators extensively discussed the change made to section 428(b)(3) of the HEA. For many years, there has been a regulatory prohibition, based on section 428(b)(3) of the HEA, against a guaranty agency's offering, directly or indirectly, any premium, payment, or other inducement to an employee or

student of a school, or an entity or individual affiliated with a school, to secure applicants for FFEL Program loans. The statutory prohibition was amended by the 1998 Amendments by adding an exception so that it would not be considered a prohibited inducement for a guaranty agency to provide assistance to schools comparable to the kinds of assistance provided by the Secretary. The Department took the view that the intent of the provision is to provide the exception to assistance comparable to the kinds of assistance provided by the Secretary to schools under the Federal Direct Loan Program. Some negotiators argued that the Secretary could provide assistance under one of the many programs administered by the Department that could also benefit Federal Direct Loan schools' administration of the program. After discussion, the negotiators agreed that it would not be a prohibited inducement for a guaranty agency to provide assistance to schools comparable to the kinds of assistance provided by the Secretary to schools under, or in furtherance of, the Federal Direct Loan Program.

*Section 682.402 Death, Disability, Closed School, False Certification, and Bankruptcy Payments*

Although the proposed regulations in this section do not implement changes made by the 1998 Amendments, the negotiators agreed to propose them as improvements to the existing FFEL Program regulations.

The proposed regulations would make it easier for some borrowers to obtain closed school discharges of their loan obligations. Current regulations require a borrower to file an application if the borrower wants a discharge of his or her loan obligation based on the school closure. Under the proposed regulations, the Secretary or a guaranty agency may discharge a borrower's FFEL Program loan, without an application, if the borrower's loan was made for the same program of study and time period at the same school as a loan for which the borrower has qualified for and received a closed school discharge under the Federal Perkins Loan Program or the Federal Direct Loan Program. In addition, the Secretary, or a guaranty agency with the Secretary's approval, may discharge a borrower's FFEL Program loan, without an application, if the borrower qualifies for a discharge based on information in the Secretary's or guaranty agency's possession that would satisfy the conditions for discharging the borrower's loan obligation.

The proposed regulations also permit a lender to suspend collection efforts against an endorser (or other party that is secondarily liable) on a loan if the borrower files a petition for relief in bankruptcy. Lenders are required by the Bankruptcy Code to immediately suspend any collection efforts outside the bankruptcy proceeding against the individual who has filed. Lenders have been required by the FFEL regulations to continue collection efforts against an endorser who has not filed for bankruptcy. The non-Federal negotiators believed that this situation creates complicated servicing issues for a lender or guaranty agency and creates confusion among participants. The proposed regulations would provide for more consistent treatment of borrowers and endorsers when the borrower files a bankruptcy petition.

*Section 682.404 Federal Reinsurance Agreement*

The Secretary proposes to modify § 682.404 to reflect sections 422A, 422B, 428(c)(1), 428(c)(6), 428(c)(9)(A), 428(f), 428(l), 438(c)(2)(H)(ii), and 458 of the HEA, as added or modified by the 1998 Amendments.

These proposed regulations reflect the changes made by the 1998 Amendments to the reinsurance rates paid on a defaulted loan for which the first disbursement was made on or after October 1, 1998.

Section 682.404(g) describes the portion of borrower payments on defaulted loans that guaranty agencies are required to return to the Secretary. Specifically, the Secretary is entitled to a share of borrower payments on default claims paid using assets of the Federal Fund. The 1998 Amendments reduced the portion of collections on defaulted loans that a guaranty agency may retain and specified that the guaranty agency share must be deposited into the agency's Operating Fund. Under current regulations, guaranty agencies are authorized to retain a portion of borrower payments received on defaulted loans on which the Secretary has paid a reinsurance claim. Thus, if a borrower payment is received by a guaranty agency after the default claim was paid but before reinsurance is paid, the guaranty agency may not retain any portion of the payment. In addition to reflecting the reduced percentage a guaranty agency is authorized to retain, the Secretary is also proposing to permit guaranty agencies to retain that portion of collections on default claims paid using assets of the Federal Fund instead of default claims on which reinsurance has been paid. The Secretary believes this change would provide guaranty

agencies with an incentive to promptly pursue collections on defaulted loans.

Section 682.404(k) of the proposed regulations addresses the default aversion fee. The default aversion fee is part of the new funding model established by the 1998 Amendments for guaranty agencies. The fee is designed to provide an incentive for guaranty agencies to provide effective default aversion efforts and lower default costs.

Section 428(l) of the HEA authorizes the payment of a default aversion fee to a guaranty agency if the agency is instrumental in averting a default by a borrower who becomes 60 days delinquent in repaying a loan. Section 428(l)(2) of the HEA permits a guaranty agency to transfer a default aversion fee from the Federal Fund to the agency's Operating Fund for any loan on which a claim for default has not been paid as a result of the loan being brought into current repayment status by the guaranty agency on or before the 360th day of delinquency. For purposes of a guaranty agency's earning the default aversion fee, section 428(l)(2)(C) of the HEA defines the term "current repayment status" as "\* \* \* the borrower is not delinquent in the repayment of any principal or interest on the loan."

The negotiators agreed that a borrower who pays all past due amounts should be considered in current repayment status, but there was considerable debate concerning other conditions under which the borrower should be considered as in "current repayment status." In particular, the issue of whether a borrower who was granted forbearance by the lender to resolve a delinquency should be considered "current repayment status" for purposes of earning the default aversion fee was extensively discussed. Some negotiators were concerned that if granting forbearance earned the guaranty agency the default aversion fee, without regard to the borrower's later default, guaranty agencies would have an economic incentive to encourage lenders to be less diligent in determining the appropriate use of forbearances. Thus, some negotiators objected that this practice could result in forbearances delaying defaults but not preventing them.

Guaranty agency representatives stated that they would not be motivated by a financial incentive to earn the maximum amount of income from default aversion fees. They maintained that the potential amount they would earn (one percent of the loan balances) would be less than their costs in providing default aversion assistance. A proposal to track loans brought into

“current repayment status” through the granting of forbearance, such that the guaranty agency would earn the default aversion fee only on those that remained current for some period of time following the end of the forbearance period, was discussed extensively. Although the guaranty agency representatives were supportive of the concept, they expressed concern about the expense associated with making system modifications necessary to track individual loans.

After considerable discussion on this topic among the negotiators, those negotiators representing guaranty agencies proposed a compromise approach that resulted in a consensus on this issue. Under the proposed regulations, a guaranty agency could transfer its calculated net amount of default aversion fees from its Federal Fund to its Operating Fund in response to lender requests for default aversion assistance on delinquent loans. However, if a loan on which the agency has received the default aversion fee is subsequently paid as a default claim, the agency must rebate funds to the Federal Fund. The fees may be transferred from the Federal Fund to the Operating Fund no more frequently than monthly, may not be paid more than once on any loan, and must be equal to the net amount of—

- One percent of the unpaid principal and accrued interest on loans at the time the request for default aversion assistance is submitted by lenders to the agency during a given time period; minus
- One percent of the unpaid principal and accrued interest owed by borrowers on default claims paid by the agency during the same time period for which the fees are transferred.

Thus, if the guaranty agency is successful in assisting delinquent borrowers to avoid default, the default aversion fees are retained by the agency. However, if a delinquent borrower for whom the agency has received the default aversion fee subsequently defaults, the guaranty agency must return to the Federal Fund 1 percent of the outstanding principal and accrued interest owed by the borrower. Accordingly, if the borrower does not make any intervening payments on the loan, the agency would be required to return an amount to the Federal Fund for that borrower that is greater than the amount originally received from the Federal Fund. The returned amount would be increased by 1 percent of the interest that accrues from the date the lender submitted the default aversion request until the date the agency pays the default claim to the lender. The

Secretary believes the return of this increased amount fairly compensates the Federal Fund for the loss of the funds for the time period they were held by the guaranty agency in its Operating Fund. The committee concluded that this gross basis calculation of the default aversion fee payments results in default aversion fee payments equivalent to the amount specified in section 428(l) of the HEA without requiring a loan-by-loan tracking. In addition, the negotiators agreed that this approach is consistent with the intent of the statute and creates positive incentives for guaranty agencies to aggressively pursue default reduction.

The proposed regulations would also permit a lender to submit a request for default aversion assistance during the 60th day through the 120th day of the borrower's delinquency. If a lender submits the request after the 120th day of delinquency, the guaranty agency must provide the default aversion assistance for which it may receive the default aversion fee.

Finally, the proposed regulations include requirements that govern who can be hired to collect loans on which default aversion assistance payments have been made. Other than the guaranty agency, which is statutorily authorized to perform both roles, the same party may not perform default aversion assistance on a loan and collect on that loan during a 3-year period following the date a default claim is paid. Because the compensation for collecting on a defaulted loan is usually much greater than that received for preventing default, this regulatory provision is intended to prevent corruption of the default aversion process.

#### *Section 682.406 Conditions for Claim Payments From the Federal Fund and for Reinsurance Coverage*

The proposed regulations reflect the changes made by the 1998 Amendments to section 428(c)(2) of the HEA. The negotiators agreed that a default claim should be paid only if diligent attempts were made by the lender and guaranty agency to locate the borrower through the use of effective commercial skip tracing techniques, including contact with the school the student attended. Further, as a condition for receiving a reinsurance payment, the guaranty agency must certify to the Secretary that those diligent skip-tracing efforts were made.

#### *Section 682.409 Mandatory Assignment by Guaranty Agencies of Defaulted Loans to the Secretary*

The proposed regulations reflect the changes made by the 1998 Amendments

to section 428(c)(8) of the HEA to the standards for requiring mandatory assignment of defaulted loans by removing the transition to the Federal Direct Loan Program as one of the criteria.

#### *Section 682.410 Fiscal, Administrative, and Enforcement Requirements*

The proposed regulations would make a change to § 682.410 to reflect the establishment of a Student Loan Ombudsman's office in the Department. The proposed changes to § 682.410(b)(5) would add a requirement that a guaranty agency must inform the borrower that the Department's Student Loan Ombudsman's office is available as a dispute resolving office before the agency reports the borrower's default to a credit bureau.

#### *Section 682.411 Lender Due Diligence in Collecting Guaranty Agency Loans*

The proposed changes to this section would add a provision in § 682.411(b)(3) requiring a lender to inform a delinquent borrower that the Department's Student Loan Ombudsman's office is available as a dispute resolving office. Under the proposed regulations, a lender's failure to inform a borrower about the availability of the Student Loan Ombudsman's office would not be considered a violation of the lender due diligence requirements in § 682.411 that would cause the loan to lose insurance or reinsurance coverage.

The proposed regulations also implement the requirements of sections 428(c)(2) and 435(l) of the HEA, as modified by the 1998 Amendments. Prior to the enactment of the 1998 Amendments, section 435(l) of the HEA defined “default” in the FFEL Program as a delinquency that persisted for 180 days for loans scheduled to be repaid in monthly installments, and 240 days for loans scheduled to be repaid in less frequent installments. This definition was changed by the 1998 Amendments to 270 days and 330 days, respectively, for loans for which the first day of the 270/330-day delinquency period occurs on or after October 7, 1998. These proposed regulations would change the due diligence requirements for lenders to accommodate this new definition of default.

A lender must send a final demand letter to a delinquent borrower at least 31 days before filing a claim with the guaranty agency. When the definition of default was 180/240 days, the final demand letter was sent on or after the 151st/211th day of delinquency. Accordingly, these proposed regulations

move the timing of the final demand letter to have it sent on or after the 241st day of delinquency, or the 301st day if the loan was scheduled to be repaid less frequently than monthly.

The negotiators also discussed the collection activities that should be required during the additional 90 days of delinquency prior to default. The proposed regulations preserve the current regulatory prohibition against any "gap" in collection efforts that exceed 45 days (or 60 days for loans being transferred from one lender or servicer to another). However, other than the timing of the final demand letter, the proposed regulations do not make any additional changes to § 682.411 at this time (other than including notification of the Ombudsman, as discussed earlier).

The proposed regulations require a lender to request default aversion assistance not earlier than the 60th day and no later than the 120th day of delinquency. If a lender fails to request default aversion assistance between the 60th and 120th day of delinquency, and the lender later submits a claim on that loan, the lender would be subject to the interest penalty described in section I.C.3.b. of Appendix D to Part 682. A default aversion assistance request must be made before the 330th day of delinquency. If the lender fails to request default aversion assistance by the 330th day, the Secretary will not pay any accrued interest, interest benefits, and special allowance for the most recent 270 days prior to default.

The current due diligence requirements in § 682.411 provide for a detailed set of requirements pertaining to the collection of delinquent loans by lenders. The Department and the FFEL community are interested in moving toward a performance-based model for due diligence. Thus, the Secretary provides notice that the Department will entertain proposals from FFEL participants to exercise the Secretary's authority to waive potential liabilities in conjunction with approved experiments with performance-based approaches to default prevention. The Secretary will evaluate proposals and may authorize the implementation of one or more experiments to test new performance-based approaches to default prevention. The Secretary encourages FFEL participants to consider proposals that create positive incentives for default prevention and that incorporate collection approaches that have been used successfully in the private sector.

*Section 682.412 Consequences of the Failure of a Borrower or Student To Establish Eligibility*

The proposed regulations make a conforming change to reflect a revised regulatory citation for the final demand letter required by § 682.411(f).

*Section 682.413 Remedial Actions*

The proposed regulations would amend this section to reflect changes made to section 428(c)(9)(I) of the HEA by the 1998 Amendments. The HEA provides that the Secretary's decision to terminate a guaranty agency's participation in the FFEL Program after September 24, 1998, based on certain failures specified in the HEA, does not become final until the Secretary provides the agency with an opportunity for a hearing on the record. The HEA requires a hearing on the record only in those cases in which the proposed termination is based on the specific grounds included in section 428(c)(9) of the HEA. The Department's regulations have long identified other grounds on which a guaranty agency's participation could be terminated, and the Department could have applied the new statutory requirement to only the limited number of statutory terminations. The Secretary suggested, however, that the hearing on the record requirement apply to any proposed termination action against a guaranty agency, and the committee agreed to this expansion.

*Section 682.414 Records, Reports, and Inspection Requirements for Guaranty Agency Programs*

Although the proposed regulations in this section do not implement changes made by the 1998 Amendments, the negotiators agreed to propose them as improvements to the existing FFEL Program regulations.

The Secretary published final regulations in the **Federal Register** (61 FR 60490, November 27, 1996) reducing the 5-year record retention requirement for schools to 3 years as a result of changes made to the General Education Practices Act (GEPA) by the Improving America's Schools Act of 1994 (Pub. L. 103-382). At that time, the Secretary received requests that the 5-year record retention requirement for lenders be similarly reduced. The Secretary declined to do so and noted that the GEPA changes did not apply to lenders in the FFEL Program.

However, the Secretary made a commitment to consider a future reduction in lender record retention requirements in the interest of reducing lender burden. The proposed

regulations reduce the length of time a lender must retain required loan records for loans paid in full by the borrower from 5 years to 3 years from the date the loan is repaid in full by the borrower. For all other loans for which the lender receives payment in full from any other source (for example, a claim payment or a consolidation payoff), or for those loans that are not paid in full, the 5-year retention period will continue to be in effect, except that in particular cases, the Secretary or the guaranty agency may require the retention of records beyond the 3-year or 5-year minimum periods. The Secretary notes that a guaranty agency could serve as a lender's agent for the purpose of maintaining the lender's records for the required time periods. The Secretary believes that the limited exception to the 5-year rule included in these proposed regulations would not interfere with appropriate program administration.

*Section 682.417 Determination of Federal Fund or Assets To Be Returned*

The changes in these proposed regulations are needed to conform this section to the new financial structure for guaranty agencies under section 422A of the HEA, which was added to the HEA by the 1998 Amendments. The Secretary proposes to change all references to "reserve funds" (or "reserve fund") in § 682.417 to "Federal Fund" to reflect the new financing model established by the 1998 Amendments. As this is done, minor grammatical changes will be made to the current regulations to accommodate the switch from the plural form of "reserve funds" to the singular form of "Federal Fund."

*Section 682.418 Prohibited Uses of the Assets of the Operating Fund During Periods in Which the Operating Fund Contains Transferred Funds Owed to the Federal Fund*

The proposed regulations would implement the requirements of section 422B(e)(3)(B) of the HEA, which authorizes the Secretary to regulate the uses or expenditures of a guaranty agency's Operating Fund during any period in which funds transferred from the Federal Fund are in the Operating Fund. The negotiators agreed that the restrictions governing the use of the reserve fund in § 682.418 would be acceptable restrictions for the use of the Operating Fund during these periods. Changing the references to "reserve fund" in the existing § 682.418 to "Operating Fund" required no new regulations.

*Section 682.419 Guaranty Agency Federal Fund*

The proposed regulations reflect section 422A of the HEA, as added by the 1998 Amendments, which requires each guaranty agency to establish a Federal Student Loan Reserve Fund (the "Federal Fund") within 60 days of enactment of the 1998 Amendments.

On January 27, 1999, the Secretary issued a "Dear Colleague Letter" (99-G-316) that provided the Secretary's initial guidance to the guaranty agencies concerning the implementation of the new guaranty agency funding model. Specifically, among other issues, the Secretary stated " \* \* \* all of the funds, securities, and other liquid assets in the agency's reserve fund as of September 30, 1998, as described in 34 CFR 682.410(a), must be deposited into the Federal Fund when it is established." The committee agreed that the date to be used for determining the amount of Federal reserve fund assets to be deposited into the newly established Federal Fund should not be included in these proposed regulations since that date was relevant at only one point in time.

In addition to other receipts, as specified in the Department's regulations, the HEA requires a guaranty agency to deposit revenue from the following sources into the Federal Fund:

- Default reinsurance payments received from the Secretary.
- A percentage of collections equal to the complement of the reinsurance percentage paid on a defaulted loan.
- Insurance premiums collected from borrowers pursuant to § 428(b)(1)(H) and § 428H(h) of the HEA.
- All amounts received from the Secretary as payment for supplemental preclaims activity performed on or before September 30, 1998.
- 70 percent of amounts received on or after October 1, 1998, as payment for administrative cost allowances for loans upon which insurance was issued on or before September 30, 1998.

The negotiators also agreed that, in addition to the deposits specifically listed in the HEA, the proposed regulations should also require the following other amounts to be deposited into the Federal Fund:

- Payments made to the agency by the Secretary on death, disability, bankruptcy, and loan cancellation and discharge claims.
- All funds received by the guaranty agency from any source (including collections from defaulted borrowers) on FFEL Program loans on which the Secretary has paid a claim, minus the portion the agency is authorized to deposit in its Operating Fund.

- Investment earnings on the Federal Fund assets.

- Revenue derived from the Federal portion of a nonliquid asset, in accordance with § 682.420.

- Other funds received by the guaranty agency from any source that are specifically designated for deposit in the Federal Fund.

As written, section 422A(d) of the HEA would permit the assets of the Federal Fund to be used only to pay lender claims and to transfer earned default aversion fees to the agency's Operating Fund. However, other provisions of the HEA authorize or require that the Federal Fund be used for other purposes. These proposed regulations recognize that the Federal Fund has to be used for other purposes, including—

- Transferring account maintenance fees to the agency's Operating Fund, if directed by the Secretary;
- Refunding payments made by or on behalf of a borrower on a loan that has been discharged due to death, disability, bankruptcy, closed school, false certification, or unpaid refund, in accordance with § 682.402;
- Paying the Secretary's share of collections on defaulted loans, in accordance with § 682.404(g);
- Transferring funds to the agency's Operating Fund, pursuant to § 682.421;
- Refunding insurance premiums related to loans cancelled or refunded, in whole or in part;
- Returning to the Secretary portions of the Federal Fund required to be returned by law; and
- Any other purpose authorized by the Secretary.

The Federal Fund (and amounts in the Operating Fund that are transferred from the Federal Fund) must be invested in securities issued or guaranteed by the United States or a State or, with the approval of the Secretary, in other similarly low-risk securities selected by the guaranty agency. Guaranty agencies that have invested the Federal reserve funds in "pooled" investments as part of a State investment program may continue using that investment vehicle for the new Federal Fund without requesting specific approval from the Secretary. Earnings on the investment of the Federal Fund are the sole property of the Federal Government.

Guaranty agencies serve as fiduciaries in safeguarding Federal assets and funds entrusted to their care. Thus, guaranty agencies may not use assets of the Federal Fund for any purpose not authorized by the HEA or the Secretary. Consistent with this obligation, the proposed regulations provide that a

guaranty agency may not prepay obligations of the Federal Fund unless it demonstrates, to the satisfaction of the Secretary, that the prepayment is in the best interests of the United States.

The HEA requires a guaranty agency to maintain a minimum Federal Fund level equal to at least 0.25 percent. For the purpose of calculating this ratio, these proposed regulations provide that the numerator is the total assets of the Federal Fund including the amount of funds transferred from the Federal Fund that are in the Operating Fund, using an accrual basis of accounting. The denominator in the above ratio is the original principal amount of loans outstanding and guaranteed by the agency.

*Section 682.420 Federal Nonliquid Assets*

The proposed regulations reflect section 422A of the HEA, as added by the 1998 Amendments, that restates the longstanding principle that the Federal Fund, and nonliquid assets (such as buildings or equipment) developed or purchased by an agency in whole or in part with Federal reserve funds, regardless of who holds or controls the Federal reserve funds or assets, are the property of the United States. Under the 1998 Amendments, the ownership of an asset is prorated based on the percentage of the asset developed or purchased with Federal funds.

Section 422A of the HEA, on its face, appears to limit the use of the Federal portion of nonliquid assets to the payment of claims to lenders and the transfer of default aversion fees to the Operating Fund. Such a literal reading of the statute would prohibit an agency from using the Federal portion of nonliquid assets (such as a computer or building) for any other purpose and would significantly burden the guaranty agency's performance of its responsibilities as a guaranty agency in the FFEL Program. The HEA authorizes the Secretary to restrict or regulate the use of the Federal portion of nonliquid assets to the extent necessary to reasonably protect the Federal share of the value of those assets. The Federal regulations in effect prior to the 1998 Amendments authorized guaranty agencies to use the Federal portion of nonliquid assets for other allowable purposes, and the negotiators, including the Secretary, agreed to propose a continuation of that policy. In addition, the negotiators agreed to propose that, if a guaranty agency uses the Federal portion of a nonliquid asset (other than an intangible or intellectual property asset or a tangible asset of nominal value) in the performance of its guaranty



activities, the agency must promptly deposit into the Federal Fund an amount representing the net fair value of the use of the asset. The net fair value is the amount that would be paid to use a similar non-Federal asset, minus amounts paid by the agency for expenses that normally would be paid by the owner of the asset.

Guaranty agencies must exercise the level of care required of a fiduciary charged with protecting, investing, and administering the property of others in maintaining and using the Federal portion of nonliquid assets under their control. Accordingly, if the guaranty agency converts the Federal portion of a nonliquid asset, in whole or in part, to a use unrelated to its guaranty activities, the agency promptly must deposit into the Federal Fund a fair percentage of the fair market value or, in the case of a temporary conversion, the net fair value of the portion of the asset employed for the unrelated use.

*Section 682.421 Funds Transferred From the Federal Fund to the Operating Fund by a Guaranty Agency*

The proposed regulations reflect section 422A(f) of the HEA, as added by the 1998 Amendments, permitting a guaranty agency to transfer a limited amount of funds from the Federal Fund for deposit into the agency's Operating Fund. Upon receiving the Secretary's approval, an agency may transfer from the Federal Fund an amount up to the equivalent of 180 days of cash expenses (not including claim payments) for normal operating expenses for deposit into the agency's Operating Fund. The amount transferred and outstanding at any time during the first 3 years after establishing the Operating Fund may not exceed the lesser of 180 days cash expenses (not including claim payments) or 45 percent of the balance in the Federal reserve fund that existed under § 682.410 as of September 30, 1998. During any period that an agency's Operating Fund contains funds transferred from its Federal Fund, the Operating Fund may be used only as permitted by § 682.410(a)(2) and § 682.418.

The negotiators agreed on the application procedures that guaranty agencies are to use in requesting approval to transfer funds from their Federal Funds to their Operating Funds. Specifically, a guaranty agency must provide the Secretary with an application containing the following:

- A request for the transfer that specifies the desired amount, the date the funds will be needed, and the agency's proposed terms of repayment.

- A projected revenue and expense statement, to be updated annually during the repayment period, that demonstrates that the agency will be able to repay the transferred amount within the repayment period requested by the agency.

- A certification by the agency that, during the period the transferred funds are outstanding, sufficient funds will remain in the Federal Fund to pay lender claims.

- A certification by the agency that it will be able to meet the reserve recall requirements of section 422 of the HEA, and the statutory minimum reserve level of 0.25 percent, as mandated by section 428(c)(9) of the HEA.

- A certification by the agency that no legal prohibition exists that would prevent the agency from obtaining or repaying the transferred funds.

Section 422A(f)(2) of the HEA also authorizes the Secretary to permit a limited number of guaranty agencies, in certain limited cases, to transfer an amount greater than 180 days of operating expenses (not including claim payments). The Secretary may authorize an agency to exceed the 180-day limit by the amount of income earned on the investment of the Federal Fund during the 3-year period following October 7, 1998 (the date of enactment of the 1998 Amendments.) During any period that an agency's Operating Fund contains funds transferred from its Federal Fund, the Operating Fund may be used only as permitted by § 682.410(a)(2) and § 682.418.

To obtain approval to transfer the investment income, an agency must have transferred, and have outstanding, the maximum amount it is otherwise eligible to transfer. In addition to the previously listed application items required for transferring principal amounts from the Federal Fund, an agency seeking to transfer investment income must demonstrate to the Secretary that the cash flow in the Operating Fund will be negative without the transfer of the investment earnings of the Federal Fund and that the transfer of those earnings will substantially improve the financial circumstances of the guaranty agency.

If the Secretary has neither approved nor disapproved a guaranty agency's requested transfer of principal or the investment earnings of the Federal Fund within 30 days after receiving the previously described application items, the agency may proceed with the transfer.

The Secretary recognizes that guaranty agencies may have transferred funds from the Federal Fund to the Operating Fund as a working capital

reserve before receiving the Department's January 27, 1999 "Dear Colleague Letter" (99-G-316) guidance concerning the implementation of the new guaranty agency funding model. A guaranty agency that transferred funds (that are still outstanding) without obtaining the Secretary's approval prior to receiving the Department's guidance will be held harmless, subject to the agency providing the Secretary with the previously described application material. Agencies that transferred Federal Fund assets into their Operating Funds are requested to provide the required application material within 60 days following publication of these proposed regulations.

*Section 682.422 Guaranty Agency Repayment of Funds Transferred From the Federal Fund*

The proposed regulations would implement the requirements of section 422A(f) of the HEA, as added by the 1998 Amendments.

Except in regard to the repayment of investment earnings transferred from the Federal Fund to the Operating Fund, the HEA requires an agency to begin repayment of principal transferred from the Federal Fund not later than the start of the fourth year after the establishment of the Operating Fund. All amounts transferred must be repaid in full not later than 5 years after the date the Operating Fund is established.

Generally, a guaranty agency must repay investment earnings transferred under section 422A(f)(2) of the HEA within 2 years. The HEA authorizes the Secretary to extend the period for repayment of investment earnings from 2 years to 5 years if the Secretary determines that the cash flow of the agency's Operating Fund will be negative if the transferred investment earnings were required to be repaid earlier or the repayment of the earnings would substantially diminish the financial circumstances of the agency. To receive an extension, the agency must demonstrate that it will be able to repay all transferred funds by the end of the eighth year following the date of establishment of the Operating Fund and that the agency will be financially sound upon the completion of repayment. Repayment of amounts transferred from the Federal Fund pursuant to section 422A(f)(2) of the HEA that are repaid during the sixth, seventh, and eighth years following the establishment of the Operating Fund must include the amount transferred, plus any income earned after the fifth year from the investment of the transferred amount. In determining the amount of income earned on the

transferred amount, the negotiators agreed that the proposed regulations should provide that the Secretary will use the average investment income earned on all the agency's investments, including investments that are not part of the agency's Operating Fund.

In accordance with section 422A(f) of the HEA, if an agency fails to make a scheduled repayment to the Federal Fund, the agency may not receive any other Federal funds until the agency becomes current in making all scheduled payments, unless the Secretary waives this restriction.

#### *Section 682.423 Guaranty Agency Operating Fund*

The proposed regulations would implement section 422B of the HEA, as added by the 1998 Amendments, which requires each guaranty agency to establish a fund designated as the "Operating Fund" within 60 days after the enactment of the 1998 Amendments. The Operating Fund must be in an account that is separate from the Federal Fund. The HEA requires an agency to deposit into the Operating Fund:

- Loan processing and issuance fees.
- 30 percent of administrative cost allowances received after October 1, 1998, for loans upon which insurance was issued before October 1, 1998.
- Account maintenance fees.
- Default aversion fees.
- Amounts remaining from collections of defaulted loans after payment of the Secretary's equitable share and depositing the complement of the reinsurance percentage into the Federal Fund.
- Amounts transferred from the Federal Fund.
- Other receipts as specified in the Secretary's regulations.

Except for funds an agency transfers from the Federal Fund under section 422A(f) of the HEA, the Operating Fund is considered the property of the guaranty agency. The HEA authorizes the Secretary to regulate the uses or expenditure of the Operating Fund during any period in which a guaranty agency owes money to the Federal Fund. These proposed regulations would implement these requirements by providing that § 682.410(a)(2) and § 682.418 apply to the use of the Operating Fund during periods in which transfers from the Federal Fund are outstanding.

Section 422B(d)(1) of the HEA specifies that funds in the Operating Fund must be used for certain activities. Those activities are application processing, loan disbursement, enrollment and repayment status management, default aversion,

collection activities, school and lender training, financial aid awareness and outreach activities, compliance monitoring, and other student financial aid related activities, as selected by the guaranty agency. In addition to those specified activities, the negotiators agreed that the Operating Fund should also be permitted to be used to pay for other "guaranty agency-related activities." Some of the negotiators, however, expressed concern that "other student aid-related activities, as selected by the guaranty agency" was too ambiguous and proposed that more specificity be included in the proposed regulations to more narrowly focus the use of the funds in the Operating Fund for this purpose. The negotiators ultimately agreed to include a requirement that the financial aid-related activities must be for the benefit of students. The Secretary will gather data concerning the use of funds in agencies' Operating Funds for financial aid-related activities that benefit students and will make the data available to the public.

#### *Section 682.800 Prohibition Against Discrimination as a Condition for Receiving Special Allowance Payments*

The 1998 Amendments repealed the requirements of the "Plan for doing business" for authorities using tax-exempt financing, except for the non-discrimination provisions. In addition, the reference to "handicapped status" in the nondiscrimination factors listed in section 438(e) of the HEA was changed to "disability status."

#### *Appendix D—Policy for Waiving the Secretary's Right To Recover or Refuse To Pay Interest Benefits, Special Allowance, and Reinsurance on Stafford, PLUS, Supplemental Loans for Students, and Consolidation Program Loans Involving Lenders' Violations of Federal Regulations Pertaining to Due Diligence in Collection or Timely Filing of Claims [Bulletin 88-G-138]*

The proposed regulations would revise Appendix D to incorporate the new default definition (270 days of delinquency or 330 days for loans paid less frequently than monthly).

#### **Executive Order 12866**

##### *1. Potential Costs and Benefits*

Under Executive Order 12866, we have assessed the potential costs and benefits of this regulatory action.

The potential costs associated with the proposed regulations are those resulting from statutory requirements and those we have determined as necessary for administering this

program effectively and efficiently. Elsewhere in this **SUPPLEMENTARY INFORMATION** section we identify and explain burdens specifically associated with information collection requirements. See the heading Paperwork Reduction Act of 1995.

In assessing the potential costs and benefits—both quantitative and qualitative—of this regulatory action, we have determined that the benefits would justify the costs.

We have also determined that this regulatory action would not unduly interfere with State, local, and tribal governments in the exercise of their governmental functions.

We note that, as these proposed regulations were subject to negotiated rulemaking, the costs and benefits of the various requirements were discussed thoroughly by negotiators. The resultant consensus reached on a particular requirement generally reflected agreement on the best possible approach to that requirement in terms of cost and benefit.

#### **Summary of Potential Costs and Benefits**

The following is an analysis of the costs and benefits of the most significant provisions of the proposed regulations, all of which reflect statutory changes included in the 1998 Amendments. There are additional proposed changes, some of which do not result from the 1998 Amendments, intended to further improve the administration of the FFEL Program, which are discussed elsewhere in this preamble under the heading *Proposed Regulatory Changes*. The Department does not consider there to be significant costs associated with those provisions.

#### **Payment of Special Allowance on FFEL Loans**

Section 682.302 incorporates the statutory modification of the formula for calculating the amount of special allowance payable on FFEL Program loans. Loan holders in the FFEL Program may receive an interest subsidy, called special allowance, from the Government to ensure a guaranteed rate of return on their loans.

Prior to the passage of the 1998 Amendments, the special allowance formula for new Federal Stafford loans (subsidized or unsubsidized) was to be based on a security of comparable maturity (the 10–20 year bond interest rate) plus 1 percent. As such, the Government would have paid loan holders a special allowance if the 10–20 year bond interest rate plus 1 percent for in-school, grace, deferment, and repayment periods was higher than the

interest rates charged to borrowers (which are capped at 8.25 percent).

Under the proposed regulations, for new Federal Stafford loans, the Government would pay loan holders a special allowance if the 91-day Treasury-bill (T-bill) interest rate for a given quarter, plus 2.8 percent (or 2.2 percent during in-school, grace, and deferment periods) is higher than the current interest rates charged to borrowers (with borrower interest rates capped at 8.25 percent).

The 1998 Amendments also changed the basis for calculating borrower interest rates on new Federal Stafford loans from a security of comparable maturity plus 1 percent for both in-school and repayment periods to the 91-day T bill interest rate plus 1.7 percent for in-school, grace, and deferment periods, and the 91-day T-bill interest rate plus 2.3 percent for repayment. When the 1998 Amendments was enacted, the 91-day T-bill interest rate plus 2.3 percent was equal to the 10–20 year bond interest rate plus 1 percent. As a result, this change had no financial impact for loans in repayment.

The 1998 Amendments included, in addition to the traditional special allowance payments, a loan-holder special interest subsidy of 0.50 percent above the borrower interest rates at all times. This new subsidy would provide loan holders \$183 million for loans during in-school, grace, and deferment status, and \$407 million for loans in

repayment, for a total benefit to loan holders and a cost to the Federal Government of \$590 million for loans originated in FY 2000.

**Federal Reinsurance Agreement**

Section 682.404 incorporates several changes, discussed in detail elsewhere in this preamble under the heading *Proposed Regulatory Changes*, associated with the restructuring of guaranty agencies under the 1998 Amendments. The statute moves toward a more performance-based system with the establishment of a new funding and operating structure for guaranty agencies.

The changes incorporated in § 682.404 that have costs and benefits for the Federal Government and for guaranty agencies are outlined in the following discussion. For comparison purposes, the amounts shown (except where noted) are for the life of loans originated in FY 2000, as determined by the Credit Reform Act of 1990.

- The default reinsurance payment—the amount guaranty agencies are reimbursed for claim payments to loan holders on defaulted loans made on or after October 1, 1998—was reduced from 98 percent to 95 percent.
- The default collection retention percentage—the percentage guaranty agencies may retain on defaulted loan collections—was reduced from 27 percent to 24 percent, until October 1, 2003 when the rate is further reduced to 23 percent.

[In millions of dollars]

- New fees were created that replace the Administrative Cost Allowance. The new loan processing and issuance fee is 0.65 percent of the total principal amount of the loans on which a guaranty agency issued insurance in a given fiscal year. Beginning October 1, 2003 the percentage is reduced to 0.40 percent. The account maintenance fee is 0.12 percent of the original principal amount of outstanding loans. After fiscal year 2000, the fee is 0.10 percent of the original principal amount of outstanding loans.

Reducing guaranty agency default reinsurance and default retention would decrease guaranty agency revenues by \$111 million and \$68 million, respectively, for loans originated in FY 2000. Guaranty agency revenue for loans originated in FY 2000 would increase by \$154 million for the loan processing and issuance fee and \$213 million for the account maintenance fee. (The account maintenance fee is paid on all outstanding loans; for FY 2000, guaranty agencies are expected to receive \$212 million in cash for this fee.) The net benefit to guaranty agencies, and the net cost to the Federal Government, would be \$188 million for loans originated in FY 2000. These revenues and costs are a direct result of changes made to the HEA by the 1998 Amendments, and have been implemented prior to the development of these proposed regulations.

Provision	Costs to the Government	Costs to guaranty agencies
Reducing guaranty agency default reinsurance .....	(\$111)	\$111
Reducing guaranty agency default retention .....	(68)	68
New loan processing and issuance fee .....	154	(154)
New account maintenance fee .....	213	(213)
<b>Net Total .....</b>	<b>188</b>	<b>(188)</b>

The 1998 Amendments also made a number of changes to the qualifications and procedures for certain transfers between the Federal Fund and the Operating Fund, which will not have an effect on the overall assets managed by the guaranty agencies.

**2. Clarity of the Regulations**

Executive Order 12866 and the President's Memorandum of June 1, 1998 on "Plain Language in Government Writing" require each agency to write regulations that are easy to understand.

The Secretary invites comments on how to make these proposed regulations easier to understand, including answers to questions such as the following:

- Are the requirements in the proposed regulations stated clearly?
- Do the proposed regulations contain technical terms or other wording that interferes with their clarity?
- Does the format of the proposed regulations (groupings and order of sections, use of headings, paragraphing, etc.) aid or reduce their clarity?
- Would the proposed regulations be easier to understand if we divided them into more (but shorter) sections? (A "section" is preceded by the symbol "\$" and a numbered heading; for example, § 682.205 Disclosure requirements for lenders.)
- Could the description of the proposed regulations in the **SUPPLEMENTARY INFORMATION** section of

this preamble be more helpful in making the proposed regulations easier to understand? If so, how?

- What else could we do to make the proposed regulations easier to understand?

Send any comments that concern how the Department could make these proposed regulations easier to understand to the person listed in the **ADDRESSES** section of the preamble.

**Regulatory Flexibility Act Certification**

The Secretary certifies that these proposed regulations would not have a significant economic impact on a substantial number of small entities.

Entities affected by these proposed regulations are guaranty agencies and lenders that participate in the Title IV, HEA programs. The 36 guaranty agencies are State and private nonprofit entities that act as agents of the Federal Government and are not considered small entities for this purpose. Nearly all of the roughly 4,800 participating FFEL loan holders would be defined as small entities under U.S. Small Business Administration (SBA) guidelines. (Student loans are originated by lenders and are often sold in packages to larger secondary market participants.) Small lenders originate only 16 percent of new loans. The economic impact for loans originated in FY 2000 would be \$30 million or approximately \$6,300 per average lender.

The Secretary invites comments on this determination, and welcomes proposals on any significant alternatives that would satisfy the same legal and policy objectives of these proposals while minimizing the economic impact on small entities.

#### **Paperwork Reduction Act of 1995**

Sections 682.305, 682.402, 682.404, 682.414, and 682.421 contain information collection requirements. Under the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Department of Education has submitted a copy of these sections to the Office of Management and Budget (OMB) for its review.

*Collection of Information:* Federal Family Education Loan Program. Documentation and notification requirements.

Guaranty agencies receive payments from the Secretary and others for exclusive use in the FFEL Program. With respect to a guaranty agency's Federal Fund, the accumulated surplus of those payments over permissible expenditures is Federal property to be returned to the Secretary upon the guaranty agency's termination or under certain other circumstances. The same is true with respect to the guaranty agency's Operating Fund if the Operating Fund contains Federal money. The Secretary needs and uses the information to determine whether the guaranty agencies comply with the requirements for safeguarding this property and the limitations on it.

*Collection of Information:* Requirement for lenders to submit ED Form 799 (request for interest and special allowance).

These proposed regulations would affect all FFEL lenders who owe origination and loan fees to the Secretary. The 1998 Amendments requires the Secretary to collect

origination and loan fees owed by a lender by offsetting the amount of interest and special allowance payments due the lender or by collecting the amount of fees directly from the lender. These proposed regulations would require a lender that owes fees to the Secretary to submit a quarterly ED Form 799 (or comply with whatever successor process to the ED Form 799 may exist in the future) even if the lender is not owed, or does not wish to receive, interest benefits or special allowance payments from the Secretary. The Department already estimates the amount of hours a lender needs each year to prepare and submit ED Form 799s under currently approved OMB inventory control number 1840-0034. Under existing regulations, a lender is required to submit an ED Form 799 only if it wants to receive interest and special allowance payments from the Federal Government. The Secretary will ask OMB to adjust the estimate of reporting hours on OMB inventory control number 1840-0034 to reflect that the proposed regulations would change the lender's option to submit an ED Form 799 to a requirement to submit the form (or comply with whatever successor process to the ED Form 799 may exist in the future).

*Collection of Information:* Closed school discharge of a borrower's loan obligation without an application form.

These proposed regulations would affect the potential loan discharge for FFEL borrowers who have received a discharge of their Federal Perkins Loan or their Federal Direct Loan, or who the Secretary or the guaranty agency, with the Secretary's permission, determines qualify for a discharge based on information in the Secretary or guaranty agency's possession. These FFEL borrowers would not need to submit a closed school loan discharge application to receive a discharge. The total burden hour reduction (based on approximately 30 minutes per application) is not expected to be substantial because of the small number of borrowers who would fall within these criteria.

*Collection of Information:* Annual notification to schools by guaranty agencies that schools can request an automatic notification of default aversion assistance requests.

The proposed regulations require a guaranty agency to accept a blanket request from a school to be notified whenever any of the school's current or former students are the subject of a default aversion assistance request. The agency must notify schools annually of the option to make this blanket request. Currently, there are 5,899 schools in the FFEL Program, and many of them

participate with more than one guaranty agency. Although the number of schools participating with multiple guaranty agencies is not known, the collective burden for the agencies should be minimal. It probably should not take a guaranty agency more than an average of 6 minutes to notify each school.

*Collection of Information:*

Submissions of default aversion assistance requests by lenders and performance of default aversion assistance activities by guaranty agencies.

Under these proposed regulations, default aversion assistance essentially replaces the former preclaims and supplemental preclaims assistance process. The renaming of this process, whereby a guaranty agency assists the lender in attempting to prevent a default by a borrower who is at least 60 days delinquent, should not result in a change to the current burden hour estimate associated with the former process of requesting and providing such assistance.

*Collection of Information:* Reduction in the length of time a lender must retain loan records.

These proposed regulations would affect all FFEL lenders by reducing the length of time a lender must retain required loan records for loans paid in full by the borrower from 5 years to 3 years from the date the loan is repaid in full by the borrower. For all other loans for which the lender receives payment in full from any other source (for example, a claim payment or a consolidation payoff), or for those loans that are not paid in full, the 5-year retention period will continue to be in effect, except that in particular cases, the Secretary or the guaranty agency may require the retention of records beyond the 3-year or 5-year minimum periods. A guaranty agency could serve as a lender's agent for the purpose of maintaining the lender's records for the required time periods.

The Department already estimates the financial cost and amount of hours a lender needs each year to maintain loan records under currently approved OMB inventory control number 1840-0538. The estimate of lender burden hours required to maintain loan records will not be shown in these proposed regulations because that estimate is not affected by the proposed reduction in the length of the minimum record retention period. The Secretary will ask OMB to adjust the financial cost estimate on OMB inventory control number 1840-0538 to reflect the reduction in the length of the minimum record retention period.

*Collection of Information:* Guaranty agency option to transfer funds from the Federal Fund into the agency's Operating Fund.

A guaranty agency that wants to transfer money from the Federal Fund to its Operating Fund must provide the Secretary with the information and certifications specified in these proposed regulations. There are 36 guaranty agencies. Some may decline the opportunity to transfer funds, while others may choose to do so more than once. The amount of time required for an agency to assemble its request to the Secretary is not known at this time, but it should not be substantial because the required information and certifications either should already be known by the agency or should be easily collected.

If you want to comment on the information collection requirements, please send your comments to the Office of Information and Regulatory Affairs, OMB, room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for U.S. Department of Education. You may also send a copy of these comments to the Department representative named in the ADDRESSES section of this preamble.

We consider your comments on these proposed collections of information in—

- Deciding whether the proposed collections are necessary for the proper performance of our functions, including whether the information will have practical use;
- Evaluating the accuracy of our estimate of the burden of the proposed collections, including the validity of our methodology and assumptions;
- Enhancing the quality, usefulness, and clarity of the information we collect; and
- Minimizing the burden on those who must respond. This includes exploring the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

OMB is required to make a decision concerning the collections of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, to ensure that OMB gives your comments full consideration, it is important that OMB receives the comments within 30 days of publication. This does not affect the deadline for your comments to us on the proposed regulations.

### Intergovernmental Review

The FFEL Program is not subject to Executive Order 12372 and the regulations in 34 CFR part 79.

### Assessment of Educational Impact

The Secretary particularly requests comments on whether these proposed regulations would require transmission of information that any other agency or authority of the United States gathers or makes available.

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 (Catalog of Federal Domestic Assistance Number 84.032 Federal Family Education Loan Program)

### List of Subjects in 34 CFR Part 682

Administrative practice and procedure, Colleges and universities, Education, Loan programs—education, Reporting and recordkeeping requirements, Student aid, Vocational education.

Dated: July 12, 1999.

**Richard W. Riley,**  
 Secretary of Education.

For the reasons discussed in the preamble, the Secretary proposes to amend part 682 of Title 34 of the Code of Federal Regulations as follows:

### PART 682—FEDERAL FAMILY EDUCATION LOAN (FFEL) PROGRAM

1. The authority citation for part 682 continues to read as follows:

**Authority:** 20 U.S.C. 1071 to 1087-2, unless otherwise noted.

2. Section 682.205 is amended by:

- A. Revising paragraphs (a)(1) and (a)(2)(i).

B. Redesignating paragraphs (a)(2)(ii) through (a)(2)(xvii) as paragraphs (a)(2)(v) through (a)(2)(xx), respectively.

C. Adding new paragraphs (a)(2)(ii) through (a)(2)(iv).

D. Adding a new paragraph (a)(3).

E. Revising paragraphs (b), (c)(1), (c)(2)(i), (d), and (e).

F. Adding new paragraphs (f), (g), and (h).

### § 682.205 Disclosure requirements for lenders.

(a) \* \* \*

(1) A lender must disclose the information described in paragraph (a)(2) of this section to a borrower, in simple and understandable terms, before or at the time of the first disbursement on a Federal Stafford or Federal PLUS loan. The information given to the borrower must prominently and clearly display, in bold type, a clear and concise statement that the borrower is receiving a loan that must be repaid.

(2) \* \* \*

(i) The lender's name;

(ii) A toll-free telephone number accessible from within the United States that the borrower can use to obtain additional loan information;

(iii) The address to which correspondence with the lender and payments should be sent;

(iv) Notice that the lender may sell or transfer the loan to another party and, if it does, that the address and identity of the party to which correspondence and payments should be sent may change;

\* \* \* \* \*

(3) With the exception of paragraphs (a)(2)(i) through (a)(2)(iii), (a)(2)(v) through (a)(2)(vii), and (a)(2)(xx) of this section, the promissory note approved by the Secretary satisfies these disclosure requirements.

(b) *Separate statement of borrower rights and responsibilities.* In addition to the disclosures required by paragraph (a) of this section, the lender must provide the borrower with a separate written statement, using simple and understandable terms, at or prior to the time of the first disbursement, that summarizes the rights and responsibilities of the borrower with respect to the loan. The statement must also warn the borrower about the consequences described in paragraph (a)(2)(xvi) of this section if the borrower defaults on the loan. The Borrower's Rights and Responsibilities statement approved by the Secretary satisfies this requirement.

(c) \* \* \*

(1) The lender must disclose the information described in paragraph (c)(2) of this section, in simple and

understandable terms, in a statement provided to the borrower at or prior to the beginning of the repayment period. In the case of a Federal Stafford or Federal SLS loan, the disclosures required by this paragraph must be made not less than 30 days nor more than 240 days before the first payment on the loan is due from the borrower. If the borrower enters the repayment period without the lender's knowledge, the lender must provide the required disclosures to the borrower immediately upon discovering that the borrower has entered the repayment period.

(2) \* \* \*

(i) The lender's name, a toll free telephone number accessible from within the United States that the borrower can use to obtain additional loan information, and the address to which correspondence with the lender and payments should be sent;

\* \* \* \* \*

(d) *Exception to disclosure requirement.* In the case of a Federal PLUS loan, the lender is not required to provide the information in paragraph (c)(2)(viii) of this section if the lender, in lieu of that disclosure, provides the borrower with sample projections of the monthly repayment amounts assuming different levels of borrowing and interest accruals resulting from capitalization of interest while the student is in school. Sample projections must disclose the cost to the borrower of principal and interest, interest only, and capitalized interest. The lender may rely on the PLUS promissory note and associated materials approved by the Secretary for purposes of complying with this section.

(e) *Borrower may not be charged for disclosures.* The lender must provide the information required by this section at no cost to the borrower.

(f) *Method of disclosure.* Any disclosure of information by a lender under this section may be through written or electronic means.

(g) *Plain language disclosure.* The plain language disclosure text, as approved by the Secretary, must be provided to a borrower in conjunction with subsequent loans taken under a previously signed Master Promissory Note. The requirements of paragraphs (a) and (b) of this section are satisfied for subsequent loans if the borrower is sent the plain language disclosure text and an initial disclosure containing the information required by paragraphs (a)(2)(i) through (iii), (a)(2)(v), (a)(2)(vi), (a)(2)(vii), and (a)(2)(xx) of this section.

(h) *Notice of availability of income-sensitive repayment option.*

(1) At the time of offering a borrower a loan and at the time of offering a

borrower repayment options, the lender must provide the borrower with a notice that informs the borrower of the availability of income-sensitive repayment. This information may be provided in a separate notice or as part of the other disclosures required by this section. The notice must inform the borrower—

- (i) That the borrower is eligible for income-sensitive repayment, including through loan consolidation;
- (ii) Of the procedures by which the borrower can elect income-sensitive repayment; and
- (iii) Of where and how the borrower may obtain more information concerning income-sensitive repayment.

(2) The promissory note and associated materials approved by the Secretary satisfy the loan origination notice requirements provided for in paragraph (h)(1) of this section.

3. Section 682.207 is amended by revising paragraph (b)(1)(vi) and adding a new paragraph (b)(1)(vii) to read as follows:

**§ 682.207 Due diligence in disbursing a loan.**

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(vi) Except as provided in paragraph (d)(2) of this section, may not disburse a second or subsequent disbursement of a Federal Stafford loan to a student who has ceased to be enrolled; and

(vii) May disburse a second disbursement of a Federal Stafford loan, at the request of the school, even if the student or the school returned the first disbursement, unless the lender has information that the student is no longer enrolled.

\* \* \* \* \*

4. Section 682.208 is amended by adding a new paragraph (c)(3) to read as follows:

**§ 682.208 Due diligence in servicing a loan.**

\* \* \* \* \*

(c) \* \* \*

(3)(i) If the borrower disputes the terms of the loan in writing and the lender does not resolve the dispute, the lender's response must provide the borrower with an appropriate contact at the guaranty agency for the resolution of the dispute.

(ii) If the guaranty agency does not resolve the dispute, the agency's response must provide the borrower with information on the availability of the Student Loan Ombudsman's office.

\* \* \* \* \*

5. Section 682.210 is amended by revising paragraph (a)(5) to read as follows:

**§ 682.210 Deferment.**

(a) \* \* \*

(5) An authorized deferment period begins on the date the condition entitling the borrower to the deferment first exists; however, except for the deferments described in paragraphs (b)(1)(i) and (s)(2) of this section, a deferment cannot begin more than six months before the date the lender receives a request and documentation required for the deferment.

\* \* \* \* \*

6. Section 682.211 is amended by revising paragraph (f)(2), and adding a new paragraph (f)(10) to read as follows:

**§ 682.211 Forbearance.**

\* \* \* \* \*

(f) \* \* \*

(2) Upon the beginning of an authorized deferment period under § 682.210, or a mandatory administrative forbearance period as specified under paragraph (j)(2) of this section;

\* \* \* \* \*

(10) For a period not to exceed 3 months for a borrower who is affected by a natural disaster.

\* \* \* \* \*

**§ 682.215 [Removed]**

7. Section 682.215 is removed.

8. Section 682.302 is amended to read as follows by:

A. Revising paragraph (b)(1) and the introductory text of paragraph (b)(2).

B. In paragraph (b)(2)(ii), removing the word "or" that appears after the semi-colon.

C. In paragraph (b)(2)(iii), removing the period and adding, in its place, "; or".

Adding a new paragraph (b)(2)(iv).

E. Redesignating paragraphs (c)(1)(iii)(A) through (E) as paragraphs (c)(1)(iii)(C) through (G), respectively.

F. Revising redesignated paragraph (c)(1)(iii)(C).

G. Adding new paragraphs (c)(1)(iii)(A) and (B).

H. Revising paragraph (c)(3)(i)(A).

I. Adding a new paragraph (c)(4).

**§ 682.302 Payment of special allowance on FFEL loans.**

\* \* \* \* \*

(b) \* \* \*

(1) Except for non-subsidized Federal Stafford loans disbursed on or after October 1, 1981, for periods of enrollment beginning prior to October 1, 1992, or as provided in paragraphs (b)(2) through (b)(4), or (e) of this section, FFEL loans that otherwise meet program requirements are eligible for special allowance payments.

(2) For a loan made under the Federal SLS or Federal PLUS Program on or

after July 1, 1987 and prior to July 1, 1994, and for any Federal PLUS loan made on or after July 1, 1998 or under § 682.209(e) or (f), no special allowance is paid for any period for which the interest rate calculated prior to applying the interest rate maximum for that loan does not exceed—

(iv) 9 percent in the case of a Federal PLUS loan made on or after October 1, 1998.

(c) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(A)(1) 2.8 percent to the resulting percentage for a Federal Stafford loan for which the first disbursement is made on or after July 1, 1998; or

(2) 2.2 percent to the resulting percentage for a Federal Stafford loan for which the first disbursement is made on or after July 1, 1998 during the borrower's in-school, grace, and authorized period of deferment;

(B) 2.5 percent to the resulting percentage for a Federal Stafford loan for which the first disbursement is made on or after July 1, 1995 for interest that accrues during the borrower's in-school, grace, and authorized period of deferment;

(C) Except as provided in paragraph (c)(1)(iii)(B) of this section, 3.1 percent to the resulting percentage for a Federal Stafford Loan made on or after October 1, 1992 and prior to July 1, 1998, and for any Federal SLS, Federal PLUS, or Federal Consolidation Loan made on or after October 1, 1992;

\* \* \* \* \*

(3)(i) \* \* \*

(A) The proceeds of tax-exempt obligations originally issued prior to October 1, 1993, the income from which is exempt from taxation under the Internal Revenue Code of 1986;

\* \* \* \* \*

(4) Loans made or purchased with funds obtained by the holder from the issuance of obligations originally issued on or after October 1, 1993, and loans made with funds derived from default reimbursement collections, interest, or other income related to eligible loans made or purchased with those tax-exempt funds, do not qualify for the minimum special allowance rate specified in paragraph (c)(3)(iii) of this section, and are not subject to the 50 percent limitation on the maximum rate otherwise applicable to loans made with tax-exempt funds.

\* \* \* \* \*

9. Section 682.305 is amended by:

A. Revising the heading and paragraph (a)(1).

B. Adding new paragraphs (a)(3)(iii) through (v).

C. Revising paragraph (c)(1).

**§ 682.305 Procedures for payment of interest benefits and special allowance and collection of origination and loan fees.**

(a) \* \* \*

(1) If a lender owes origination fees or loan fees under paragraph (a) of this section, it must submit quarterly reports to the Secretary on a form provided or prescribed by the Secretary, even if the lender is not owed, or does not wish to receive, interest benefits or special allowance from the Secretary.

\* \* \* \* \*

(3) \* \* \*

(iii) The Secretary collects from an originating lender the amount of origination fees the originating lender was authorized to collect from borrowers during the quarter whether or not the originating lender actually collected those fees. The Secretary also collects the fees the originating lender is required to pay under paragraph (a)(3)(ii) of this section. Generally, the Secretary collects the fees from the originating lender by offsetting the amount of interest benefits and special allowance payable to the originating lender in a quarter, and, if necessary, the amount of interest benefits and special allowance payable in subsequent quarters may be offset until the total amount of fees has been recovered.

(iv) If the full amount of the fees cannot be collected within two quarters by reducing interest and special allowance payable to the originating lender, the Secretary may collect the unpaid amount directly from the originating lender.

(v) If the full amount of the fees cannot be collected within two quarters from the originating lender in accordance with paragraphs (a)(3) (iii) and (iv) of this section and if the originating lender has transferred the loan to a subsequent holder, the Secretary may, following written notice, collect the unpaid amount from the holder by using the same steps described in paragraphs (a)(3) (iii) and (iv) of this section, with the term "holder" substituting for the term "originating lender".

\* \* \* \* \*

(c) \* \* \*

(1) If a lender originates or holds more than \$5 million in FFEL loans during its fiscal year, it must submit an independent annual compliance audit for that year, conducted by a qualified independent organization or person. The Secretary may, following written notice, suspend the payment of interest benefits and special allowance to a lender that does not submit its audit

within the time period prescribed in paragraph (c)(2) of this section.

\* \* \* \* \*

**§ 682.400 [Amended]**

10. Section 682.400 is amended by:

A. In paragraph (b)(1)(i), adding the word "and" after the semi-colon.

B. In paragraph (b)(1)(ii), removing "and" and adding, in its place, a period.

C. Removing paragraph (b)(1)(iii).

11. Section 682.401 is amended by:

A. Revising paragraph (b)(11).

B. In the introductory text of paragraph (b)(23)(i), removing the words "as defined in § 682.800(d)".

C. Adding a heading to paragraph (c).

D. Revising paragraphs (c)(1), (c)(2), and (c)(3).

E. Adding a new paragraph (c)(5).

F. Revising paragraphs (e)(1) and (e)(3).

**§ 682.401 Basic program agreement.**

\* \* \* \* \*

(b) \* \* \*

(11) *Inquiries.* The agency must be able to receive and respond to written, electronic, and telephone inquiries.

\* \* \* \* \*

(c) *Lender-of-last-resort.* (1) The guaranty agency must ensure that it, or an eligible lender described in section 435(d)(1)(D) of the HEA, serves as a lender-of-last-resort in the State in which the guaranty agency is the designated guaranty agency. The guaranty agency or an eligible lender described in section 435(d)(1)(D) of the HEA may arrange for a loan required to be made under paragraph (c)(2) of this section to be made by another eligible lender. As used in this paragraph, the term "designated guaranty agency" means the guaranty agency in the State for which the Secretary has signed a Basic Program Agreement under § 682.401.

(2) The lender-of-last-resort must make subsidized Federal Stafford loans and unsubsidized Federal Stafford loans to any eligible student who—

(i) Qualifies for interest benefits pursuant to § 682.301;

(ii) Qualifies for a combined loan amount of at least \$200; and

(iii) Has been otherwise unable to obtain loans from another eligible lender for the same period of enrollment.

(3) The lender-of-last-resort may make unsubsidized Federal Stafford and Federal PLUS loans to borrowers who have been otherwise unable to obtain those loans from another eligible lender.

\* \* \* \* \*

(5)(i) Upon request of the guaranty agency, the Secretary may advance

Federal funds to the agency, on terms and conditions agreed to by the Secretary and the agency, to ensure the availability of loan capital for subsidized and unsubsidized Federal Stafford and Federal PLUS loans to borrowers who are otherwise unable to obtain those loans if the Secretary determines that—

(A) Eligible borrowers in a State who qualify for subsidized Federal Stafford loans are seeking and are unable to obtain subsidized Federal Stafford loans;

(B) The guaranty agency designated for that State has the capability for providing lender-of-last-resort loans in a timely manner, either directly or indirectly using a third party, in accordance with the guaranty agency's obligations under the HEA, but cannot do so without advances provided by the Secretary; and

(C) It would be cost-effective to advance Federal funds to the agency.

(ii) If the Secretary determines that the designated guaranty agency does not have the capability to provide lender-of-last-resort loans, in accordance with paragraph (c)(5)(i) of this section, the Secretary may provide Federal funds to another guaranty agency, under terms and conditions agreed to by the Secretary and the agency, to make lender-of-last-resort loans in that State.

\* \* \* \* \*

(e) \* \* \*

(1) Offer directly or indirectly any premium, payment, or other inducement to an employee or student of a school, or an entity or individual affiliated with a school, to secure applicants for FFEL loans, except that a guaranty agency is not prohibited from providing assistance to schools comparable to the kinds of assistance provided by the Secretary to schools under, or in furtherance of, the Federal Direct Loan Program;

\* \* \* \* \*

(3) Mail or otherwise distribute unsolicited loan applications to students enrolled in a secondary school or a postsecondary institution, or to parents of those students, unless the potential borrower has previously received loans insured by the guaranty agency;

\* \* \* \* \*

12. Section 682.402 is amended by:

A. Revising the introductory text following the heading of paragraph (d)(3).

B. Adding a new paragraph (d)(8).

C. Revising paragraph (f)(2).

**§ 682.402 Death, disability, closed school, false certification, and bankruptcy payments.**

\* \* \* \* \*

(d) \* \* \*

(3) \* \* \* Except as provided in paragraph (d)(7) of this section, in order to qualify for a discharge of a loan under paragraph (d) of this section, a borrower must submit a written request and sworn statement to the holder of the loan. The statement need not be notarized, but must be made by the borrower under the penalty of perjury, and, in the statement, the borrower must state—

\* \* \* \* \*

(8) *Discharge without an application.* A borrower's obligation to repay an FFEL Program loan may be discharged without an application from the borrower if the—

(i) Borrower received a discharge on a loan pursuant to 34 CFR 674.33(g) under the Federal Perkins Loan Program, or 34 CFR 685.213 under the William D. Ford Federal Direct Loan Program; or

(ii) The Secretary or the guaranty agency, with the Secretary's permission, determines that the borrower qualifies for a discharge based on information in the Secretary or guaranty agency's possession.

\* \* \* \* \*

(f) \* \* \*

(2) *Suspension of collection activity.* If the lender is notified that a borrower has filed a petition for relief in bankruptcy, the lender must immediately suspend any collection efforts outside the bankruptcy proceeding against the borrower, and may suspend collection efforts against any co-maker or endorser on the loan.

\* \* \* \* \*

13. Section 682.404 is amended to read as follows by:

A. Revising the introductory text of paragraph (a)(1).

B. Redesignating paragraph (a)(1)(ii) as (a)(1)(iii).

C. Revising paragraph (a)(1)(i), adding a new paragraph (a)(1)(ii), and revising redesignated paragraph (a)(1)(iii) introductory text.

D. Removing paragraphs (a)(2)(iii) and (a)(3), and revising paragraph (a)(2)(ii).

E. Redesignating paragraphs (a)(4) and (a)(5) as paragraphs (a)(3) and (a)(4), respectively.

F. Revising the redesignated paragraph (a)(4).

G. Revising the heading for paragraph (b), and removing the word "or" at the end of paragraph (b)(1)(i).

H. Revising paragraphs (b)(1)(ii) and (b)(2)(ii), and adding a new paragraph (b)(1)(iii).

I. Removing the word "or" after the semi-colon in paragraph (b)(2)(i).

J. Adding a new paragraph (b)(2)(iii).

K. Revising the heading for paragraph (g).

L. Revising paragraphs (g)(1) and (g)(2), and removing paragraph (g)(3).

M. Redesignating paragraph (i) as paragraph (l).

N. Adding new paragraphs (i), (j), and (k).

**§ 682.404 Federal reinsurance agreement.**

(a) \* \* \*

(1) The Secretary may enter into a reinsurance agreement with a guaranty agency that has a basic program agreement. Except as provided in paragraph (b) of this section, under a reinsurance agreement, the Secretary reimburses the guaranty agency for—

(i) 95 percent of its losses on default claim payments to lenders on loans for which the first disbursement is made on or after October 1, 1998;

(ii) 98 percent of its losses on default claim payments to lenders for loans made on or after October 1, 1993, and before October 1, 1998; or

(iii) 100 percent of its losses on default claim payments to lenders—

\* \* \* \* \*

(2) \* \* \*

(ii) *Default aversion assistance* means the activities of a guaranty agency that are designed to prevent a default by a borrower who is at least 60 days delinquent and that are directly related to providing collection assistance to the lender.

\* \* \* \* \*

(4) If a lender has requested default aversion assistance as described in paragraph (a)(2)(ii) of this section, the agency must, upon request of the school at which the borrower received the loan, notify the school of the lender's request. The guaranty agency may not charge the school or the school's agent for providing this notification and must accept a blanket request from the school to be notified whenever any of the school's current or former students are the subject of a default aversion assistance request. The agency must notify schools annually of the option to make this blanket request.

(b) *Reduction in reinsurance rate.*

(1) \* \* \*

(ii) 88 percent of its losses on default claim payments to lenders on loans made on or after October 1, 1993, and before October 1, 1998; or

(iii) 85 percent of its losses on default claim payments to lenders on loans for which the first disbursement is made on or after October 1, 1998.

(2) \* \* \*



(ii) 78 percent of its losses on default claim payments to lenders on loans made on or after October 1, 1993, and before October 1, 1998; or

(iii) 75 percent of its losses on default claim payments to lenders on loans for which the first disbursement is made on or after October 1, 1998.

\* \* \* \* \*

(g) *Share of borrower payments returned to the Secretary.*

(1) After an agency pays a default claim to a holder using assets of the Federal Fund, the agency must pay to the Secretary the portion of payments received on those defaulted loans remaining after—

(i) The agency deposits into the Federal Fund the amount of those payments equal to the applicable complement of the reinsurance percentage that was in effect at the time the claim was paid; and

(ii) The agency has deducted an amount equal to—

(A) 30 percent of borrower payments received before October 1, 1993;

(B) 27 percent of borrower payments received on or after October 1, 1993, and before October 1, 1998;

(C) 24 percent of borrower payments received on or after October 1, 1998, and before October 1, 2003; and

(D) 23 percent of borrower payments received on or after October 1, 2003.

(2) Unless the Secretary approves otherwise, the guaranty agency must pay to the Secretary the Secretary's share of borrower payments within 45 days of its receipt of the payments.

\* \* \* \* \*

(i) *Account maintenance fee.* A guaranty agency is paid an account maintenance fee based on the original principal amount of outstanding FFEL Program loans insured by the agency. For fiscal years 1999 and 2000, the fee is 0.12 percent of the original principal amount of outstanding loans. After fiscal year 2000, the fee is 0.10 percent of the original principal amount of outstanding loans.

(j) *Loan processing and issuance fee.* A guaranty agency is paid a loan processing and issuance fee based on the principal amount of FFEL Program loans originated during a fiscal year that are insured by the agency. The fee is paid quarterly. No payment is made for loans for which the disbursement checks have not been cashed or for which electronic funds transfers have not been completed. For fiscal years 1999 through 2003, the fee is 0.65 percent of the principal amount of loans originated. Beginning October 1, 2003, the fee is 0.40 percent.

(k) *Default aversion fee.*

(1) *General.* If a guaranty agency performs default aversion activities on a delinquent loan in response to a lender's request for default aversion assistance on that loan, the agency receives a default aversion fee. The fee may not be paid more than once on any loan. The lender's request for assistance must be submitted to the guaranty agency no earlier than the 60th day and no later than the 120th day of the borrower's delinquency.

(2) *Amount of fees transferred.* No more frequently than monthly, a guaranty agency may transfer default aversion fees from the Federal Fund to its Operating Fund. The amount of the fees that may be transferred is equal to—

(i) One percent of the unpaid principal and accrued interest owed on loans that were submitted by lenders to the agency for default aversion assistance; minus

(ii) One percent of the unpaid principal and accrued interest owed by borrowers on default claims that—

(A) Were paid by the agency for the same time period for which the agency transferred default aversion fees from its Federal Fund; and

(B) For which default aversion fees have been received by the agency.

(3) *Calculation of fee.*

(i) For purposes of calculating the one percent default aversion fee described in paragraph (k)(2)(i) of this section, the agency must use the total unpaid principal and accrued interest owed by the borrower as of the date the default aversion assistance request is submitted by the lender.

(ii) For purposes of paragraph (k)(2)(ii) of this section, the agency must use the total unpaid principal and accrued interest owed by the borrower as of the date the agency paid the default claim.

(4) *Prohibition against conflicts.* If a guaranty agency contracts with an outside entity to perform any default aversion activities, that outside entity may not—

(i) Hold or service the loan; or

(ii) Perform collection activities on the loan in the event of default within 3 years of the claim payment date.

\* \* \* \* \*

14. Section 682.406 is amended by revising the heading, the introductory text of paragraph (a), and paragraph (a)(14) to read as follows:

**§ 682.406 Conditions for claim payments from the Federal Fund and for reinsurance coverage.**

(a) A guaranty agency may make a claim payment from the Federal Fund

and receive a reinsurance payment on a loan only if—

\* \* \* \* \*

(14) The guaranty agency certifies to the Secretary that diligent attempts have been made by the lender and the guaranty agency under § 682.411(h) to locate the borrower through the use of effective skip tracing techniques, including contact with the school the student attended.

\* \* \* \* \*

15. Section 682.409 is amended by revising the introductory text of paragraph (a)(1) to read as follows:

**§ 682.409 Mandatory assignment by guaranty agencies of defaulted loans to the Secretary.**

(a)(1) If the Secretary determines that action is necessary to protect the Federal fiscal interest, the Secretary directs a guaranty agency to promptly assign to the Secretary any loans held by the agency on which the agency has received payment under §§ 682.402(f), 682.402(k), or 682.404. The collection of unpaid loans owed by Federal employees by Federal salary offset is, among other things, deemed to be in the Federal fiscal interest. Unless the Secretary notifies an agency, in writing, that other loans must be assigned to the Secretary, an agency must assign any loan that meets all of the following criteria as of April 15 of each year:

\* \* \* \* \*

16. Section 682.410 is amended by adding a new paragraph (b)(5)(vii) to read as follows:

**§ 682.410 Fiscal, administrative, and enforcement requirements.**

\* \* \* \* \*

(b) \* \* \*

(5) \* \* \*

(vii) As part of the guaranty agency's response to a borrower who appeals an adverse decision resulting from the agency's administrative review of the loan obligation, the agency must provide the borrower with information on the availability of the Student Loan Ombudsman's office.

\* \* \* \* \*

17. Section 682.411 is revised to read as follows:

**§ 682.411 Lender due diligence in collecting guaranty agency loans.**

(a) *General.* In the event of delinquency on an FFEL Program loan, the lender must engage in at least the collection efforts described in paragraphs (d) through (n) of this section, except that in the case of a loan made to a borrower who is incarcerated or to a borrower residing outside a State, Mexico, or Canada, the lender may send

a forceful collection letter in lieu of each telephone effort required by this section.

(b) *Delinquency.*

(1) For purposes of this section, delinquency on a loan begins on the first day after the due date of the first missed payment that is not later made. The due date of the first payment is established by the lender but must occur by the deadlines specified in § 682.209(a) or, if the lender first learns after the fact that the borrower has entered the repayment period, no later than 75 days after the day the lender so learns, except as provided in § 682.209(a)(2)(v) and (a)(3)(ii)(E). If a payment is made late, the first day of delinquency is the day after the due date of the next missed payment that is not later made. A payment that is within five dollars of the amount normally required to advance the due date may nevertheless advance the due date if the lender's procedures allow for that advancement.

(2) At no point during the periods specified in paragraphs (d) and (e) of this section may the lender permit the occurrence of a gap in collection activity, as defined in paragraph (j) of this section, of more than 45 days (60 days in the case of a transfer).

(3) As part of one of the collection activities provided for in this section, the lender must provide the borrower with information on the availability of the Student Loan Ombudsman's office.

(c) *1-15 days delinquent.* Except in the case in which a loan is brought into this period by a payment on the loan, expiration of an authorized deferment or forbearance period, or the lender's receipt from the drawee of a dishonored check submitted as a payment on the loan, the lender during this period must send at least one written notice or collection letter to the borrower informing the borrower of the delinquency and urging the borrower to make payments sufficient to eliminate the delinquency. The notice or collection letter sent during this period must include, at a minimum, a lender or servicer contact, a telephone number, and a prominent statement informing the borrower that assistance may be available if he or she is experiencing difficulty in making a scheduled repayment.

(d) *16-180 days delinquent (16-240 days delinquent for a loan repayable in installments less frequently than monthly).*

(1) Unless exempted under paragraph (d)(4) of this section, during this period the lender must engage in at least four diligent efforts to contact the borrower by telephone and send at least four collection letters urging the borrower to

make the required payments on the loan. At least one of the diligent efforts to contact the borrower by telephone must occur on or before, and another one must occur after, the 90th day of delinquency. Collection letters sent during this period must include, at a minimum, information for the borrower regarding deferment, forbearance, income-sensitive repayment and loan consolidation, and other available options to avoid default.

(2) At least two of the collection letters required under paragraph (d)(1) of this section must warn the borrower that, if the loan is not paid, the lender will assign the loan to the guaranty agency that, in turn, will report the default to all national credit bureaus, and that the agency may institute proceedings to offset the borrower's State and Federal income tax refunds and other payments made by the Federal Government to the borrower or to garnish the borrower's wages, or to assign the loan to the Federal Government for litigation against the borrower.

(3) Following the lender's receipt of a payment on the loan or a correct address for the borrower, the lender's receipt from the drawee of a dishonored check received as a payment on the loan, the lender's receipt of a correct telephone number for the borrower, or the expiration of an authorized deferment or forbearance period, the lender is required to engage in only—

(i) Two diligent efforts to contact the borrower by telephone during this period, if the loan is less than 91 days delinquent (121 days delinquent for a loan repayable in installments less frequently than monthly) upon receipt of the payment, correct address, correct telephone number, or returned check, or expiration of the deferment or forbearance; or

(ii) One diligent effort to contact the borrower by telephone during this period if the loan is 91-120 days delinquent (121-180 days delinquent for a loan repayable in installments less frequently than monthly) upon receipt of the payment, correct address, correct telephone number, or returned check, or expiration of the deferment or forbearance.

(4) A lender need not attempt to contact by telephone any borrower—

(i) Who is incarcerated;

(ii) Who is residing outside of a State, Mexico or Canada;

(iii) Whose telephone number is unknown;

(iv) Who is more than 120 days delinquent (180 days delinquent for a loan repayable in installments less

frequent than monthly) following the lender's receipt of—

(A) A payment on the loan;

(B) A correct address or correct telephone number for the borrower;

(C) A dishonored check received from the drawee as a payment on the loan; or

(D) The expiration of an authorized deferment or forbearance.

(e) *181-270 days delinquent (241-330 days delinquent for a loan repayable in installments less frequently than monthly).* During this period the lender must engage in efforts to urge the borrower to make the required payments on the loan. These efforts must, at a minimum, provide information to the borrower regarding options to avoid default and the consequences of defaulting on the loan.

(f) *Final demand.* On or after the 241st day of delinquency, (the 301st day for loans payable in less frequent installments than monthly) the lender must send a final demand letter to the borrower requiring repayment of the loan in full and notifying the borrower that a default will be reported to a national credit bureau. The lender must allow the borrower at least 30 days after the date the letter is mailed to respond to the final demand letter and to bring the loan out of default before filing a default claim on the loan.

(g) *Collection procedures when borrower's telephone number is not available.* Upon completion of a diligent but unsuccessful effort to ascertain the correct telephone number of a borrower as required by paragraph (m) of this section, the lender is excused from any further efforts to contact the borrower by telephone, unless the borrower's number is obtained before the 211th day of delinquency (the 271st day for loans repayable in installments less frequently than monthly).

(h) *Skip-tracing.*

(1) Unless the letter specified under paragraph (f) of this section has already been sent, within 10 days of its receipt of information indicating that it does not know the borrower's current address, the lender must begin to diligently attempt to locate the borrower through the use of effective commercial skip-tracing techniques. These efforts must include, but are not limited to, sending a letter to or making a diligent effort to contact each endorser, relative, reference, individual, and entity, including the school the student most recently attended, identified in the borrower's loan file. For this purpose, a lender's contact with a school official who might reasonably be expected to know the borrower's address may be with someone other than the financial aid administrator, and may be in writing

or by phone calls. These efforts must be completed by the date of default with no gap of more than 45 days between attempts to contact those individuals or entities.

(2) Upon receipt of information indicating that it does not know the borrower's current address, the lender must discontinue the collection efforts described in paragraphs (c) through (f) of this section.

(3) If the lender is unable to ascertain the borrower's current address despite its performance of the activities described in paragraph (h)(1) of this section, the lender is excused thereafter from performance of the collection activities described in paragraphs (c) through (f) and (l)(1) through (l)(3) and (l)(5) of this section unless it receives communication indicating the borrower's address before the 241st day of delinquency (the 301st day for loans payable in less frequent installments than monthly).

(4) The activities specified by paragraphs (m)(1)(i) or (ii) of this section (with references to the "borrower" understood to mean endorser, reference, relative, individual, or entity as appropriate) meet the requirement that the lender make a diligent effort to contact each individual identified in the borrower's loan file.

(i) *Default aversion assistance.* Not earlier than the 60th day and no later than the 120th day of delinquency, a lender must request default aversion assistance from the guaranty agency that guarantees the loan.

(j) *Gap in collection activity.* For purposes of this section, the term *gap in collection activity* means, with respect to a loan, any period—

(1) Beginning on the date that is the day after—

(i) The due date of a payment unless the lender does not know the borrower's address on that date;

(ii) The day on which the lender receives a payment on a loan that remains delinquent notwithstanding the payment;

(iii) The day on which the lender receives the correct address for a delinquent borrower;

(iv) The day on which the lender completes a collection activity;

(v) The day on which the lender receives a dishonored check submitted as a payment on the loan;

(vi) The expiration of an authorized deferment or forbearance period on a delinquent loan; or

(vii) The day the lender receives information indicating it does not know the borrower's current address; and

(2) Ending on the date of the earliest of—

(i) The day on which the lender receives the first subsequent payment or completed deferment request or forbearance agreement;

(ii) The day on which the lender begins the first subsequent collection activity;

(iii) The day on which the lender receives written communication from the borrower relating to his or her account; or

(iv) Default.

(k) *Transfer.* For purposes of this section, the term *transfer* with respect to a loan means any action, including, but not limited to, the sale of the loan, that results in a change in the system used to monitor or conduct collection activity on a loan from one system to another.

(l) *Collection activity.* For purposes of this section, the term *collection activity* with respect to a loan means—

(1) Mailing or otherwise transmitting to the borrower at an address that the lender reasonably believes to be the borrower's current address a collection letter or final demand letter that satisfies the timing and content requirements of paragraphs (c), (d), (e), or (f) of this section;

(2) Making an attempt to contact the borrower by telephone to urge the borrower to begin or resume repayment;

(3) Conducting skip-tracing efforts, in accordance with paragraphs (h)(1) or (m)(1)(iii) of this section, to locate a borrower whose correct address or telephone number is unknown to the lender;

(4) Mailing or otherwise transmitting to the guaranty agency a request for default aversion assistance available from the agency on the loan at the time the request is transmitted; or

(5) Any telephone discussion or personal contact with the borrower so long as the borrower is apprised of the account's past-due status.

(m) *Diligent effort for telephone contact.*

(1) For purposes of this section, the term *diligent effort* with respect to telephone contact means—

(i) A successful effort to contact the borrower by telephone;

(ii) At least two unsuccessful attempts to contact the borrower by telephone at a number that the lender reasonably believes to be the borrower's correct telephone number; or

(iii) An unsuccessful effort to ascertain the correct telephone number of a borrower, including, but not limited to, a directory assistance inquiry as to the borrower's telephone number, and sending a letter to or making a diligent effort to contact each reference, relative, and individual identified in the most recent loan application or most recent

school certification for that borrower held by the lender. The lender may contact a school official other than the financial aid administrator who reasonably may be expected to know the borrower's address or telephone number.

(2) If the lender is unable to ascertain the borrower's correct telephone number despite its performance of the activities described in paragraph (m)(1)(iii) of this section, the lender is excused thereafter from attempting to contact the borrower by telephone unless it receives a communication indicating the borrower's current telephone number before the 211th day of delinquency (the 271st day for loans repayable in installments less frequently than monthly).

(3) The activities specified by paragraph (m)(1)(i) or (ii) of this section (with references to "the borrower" understood to mean endorser, reference, relative, or individual as appropriate), meet the requirement that the lender make a diligent effort to contact each endorser or each reference, relative, or individual identified on the borrower's most recent loan application or most recent school certification.

(n) *Due diligence for endorsers.*

(1) Before filing a default claim on a loan with an endorser, the lender must—

(i) Make a diligent effort to contact the endorser by telephone; and

(ii) Send the endorser on the loan two letters advising the endorser of the delinquent status of the loan and urging the endorser to make the required payments on the loan with at least one letter containing the information described in paragraph (d)(2) of this section (with references to "the borrower" understood to mean the endorser).

(2) On or after the 241st day of delinquency, (the 301st day for loans payable in less frequent installments than monthly) the lender must send a final demand letter to the endorser requiring repayment of the loan in full and notifying the endorser that a default will be reported to a national credit bureau. The lender must allow the endorser at least 30 days after the date the letter is mailed to respond to the final demand letter and to bring the loan out of default before filing a default claim on the loan.

(3) Unless the letter specified under paragraph (n)(2) of this section has already been sent, upon receipt of information indicating that it does not know the endorser's current address or telephone number, the lender must diligently attempt to locate the endorser through the use of effective commercial

skip-tracing techniques. This effort must include an inquiry to directory assistance.

(o) *Preemption of State law.* The provisions of this section preempt any State law, including State statutes, regulations, or rules, that would conflict with or hinder satisfaction of the requirements or frustrate the purposes of this section.

(Authority: 20 U.S.C. 1078, 1078-1, 1078-2, 1078-3, 1080a, 1082, 1087)

#### § 682.412 [Amended]

18. Section 682.412 is amended by removing “§ 682.411(e)” in paragraph (a) and adding, in its place, “§ 682.411(f)”.

19. Section 682.413 is amended by revising paragraph (e)(1) to read as follows:

#### § 682.413 Remedial actions.

\* \* \* \* \*

(e)(1)(i) The Secretary's decision to require repayment of funds, withhold funds, or to limit or suspend a lender, guaranty agency, or third party servicer from participation in the FFEL Program or to terminate a lender or third party from participation in the FFEL Program does not become final until the Secretary provides the lender, agency, or servicer with written notice of the intended action and an opportunity to be heard. The hearing is at a time and in a manner the Secretary determines to be appropriate to the resolution of the issues on which the lender, agency, or servicer requests the hearing.

(ii) The Secretary's decision to terminate a guaranty agency's participation in the FFEL Program after September 24, 1998 does not become final until the Secretary provides the agency with written notice of the intended action and provides an opportunity for a hearing on the record.

\* \* \* \* \*

20. Section 682.414 is amended by revising paragraph (a)(4)(iii) to read as follows:

#### § 682.414 Records, reports, and inspection requirements for guaranty agency programs.

(a) \* \* \*

(4) \* \* \*

(iii) Except as provided in paragraph (a)(4)(iv) of this section, a lender must retain the records required for each loan for not less than three years following the date the loan is repaid in full by the borrower, or for not less than five years following the date the lender receives payment in full from any other source. However, in particular cases, the Secretary or the guaranty agency may

require the retention of records beyond this minimum period.

\* \* \* \* \*

21. Section 682.417 is amended by revising the heading and paragraphs (a) through (h) by removing the words “reserve fund” and “reserve funds” and adding, in their place, the words “Federal Fund” and “Federal funds”, respectively, wherever they appear, and making minor grammatical adjustments wherever needed to accommodate the change from a plural noun (“funds”) to a singular noun (“Fund”). As revised, § 682.417 reads as follows:

#### § 682.417 Determination of Federal funds or assets to be returned.

(a) *General.* The procedures described in this section apply to a determination by the Secretary that—

(1) A guaranty agency must return to the Secretary a portion of its Federal Fund which the Secretary has determined is unnecessary to pay the program expenses and contingent liabilities of the agency; and

(2) A guaranty agency must require the return to the agency or the Secretary of Federal funds or assets within the meaning of section 422(g)(1) of the HEA held by or under the control of any other entity, which the Secretary determines are necessary to pay the program expenses and contingent liabilities of the agency or which are required for the orderly termination of the guaranty agency's operations and the liquidation of its assets.

(b) *Return of unnecessary Federal funds.*

(1) The Secretary may initiate a process to recover unnecessary Federal funds under paragraph (a)(1) of this section if the Secretary determines that a guaranty agency's Federal Fund ratio under § 682.410(a)(10) for each of the two preceding Federal fiscal years exceeded 2.0 percent.

(2) If the Secretary initiates a process to recover unnecessary Federal funds, the Secretary requires the return of a portion of the Federal funds that the Secretary determines will permit the agency to—

(i) Have a Federal Fund ratio of at least 2.0 percent under § 682.410(a)(10) at the time of the determination; and

(ii) Meet the minimum Federal Fund requirements under § 682.410(a)(10) and retain sufficient additional Federal funds to perform its responsibilities as a guaranty agency during the current Federal fiscal year and the four succeeding Federal fiscal years.

(3)(i) The Secretary makes a determination of the amount of Federal funds needed by the guaranty agency under paragraph (b)(2) of this section on

the basis of financial projections for the period described in that paragraph. If the agency provides projections for a period longer than the period referred to in that paragraph, the Secretary may consider those projections.

(ii) The Secretary may require a guaranty agency to provide financial projections in a form and on the basis of assumptions prescribed by the Secretary. If the Secretary requests the agency to provide financial projections, the agency must provide the projections within 60 days of the Secretary's request. If the agency does not provide the projections within the specified time period, the Secretary determines the amount of Federal funds needed by the agency on the basis of other information.

(c) *Notice.*

(1) The Secretary or an authorized Departmental official begins a proceeding to order a guaranty agency to return a portion of its Federal funds, or to direct the return of Federal funds or assets subject to return, by sending the guaranty agency a notice by certified mail, return receipt requested.

(2) The notice—

(i) Informs the guaranty agency of the Secretary's determination that Federal funds or assets must be returned;

(ii) Describes the basis for the Secretary's determination and contains sufficient information to allow the guaranty agency to prepare and present an appeal;

(iii) States the date by which the return of Federal funds or assets must be completed;

(iv) Describes the process for appealing the determination, including the time for filing an appeal and the procedure for doing so; and

(v) Identifies any actions that the guaranty agency must take to ensure that the Federal funds or assets that are the subject of the notice are maintained and protected against use, expenditure, transfer, or other disbursement after the date of the Secretary's determination, and the basis for requiring those actions. The actions may include, but are not limited to, directing the agency to place the Federal funds in an escrow account. If the Secretary has directed the guaranty agency to require the return of Federal funds or assets held by or under the control of another entity, the guaranty agency must ensure that the agency's claims to those funds or assets and the collectability of the agency's claims will not be compromised or jeopardized during an appeal. The guaranty agency must also comply with all other applicable regulations relating to the use of Federal funds and assets.

(d) *Appeal.*

(1) A guaranty agency may appeal the Secretary's determination that Federal funds or assets must be returned by filing a written notice of appeal within 20 days of the date of the guaranty agency's receipt of the notice of the Secretary's determination. If the agency files a notice of appeal, the requirement that the return of Federal funds or assets be completed by a particular date is suspended pending completion of the appeal process. If the agency does not file a notice of appeal within the period specified in this paragraph, the Secretary's determination is final.

(2) A guaranty agency must submit the information described in paragraph (d)(4) of this section within 45 days of the date of the guaranty agency's receipt of the notice of the Secretary's determination unless the Secretary agrees to extend the period at the agency's request. If the agency does not submit that information within the prescribed period, the Secretary's determination is final.

(3) A guaranty agency's appeal of a determination that Federal funds or assets must be returned is considered and decided by a Departmental official other than the official who issued the determination or a subordinate of that official.

(4) In an appeal of the Secretary's determination, the guaranty agency must—

(i) State the reasons the guaranty agency believes the Federal funds or assets need not be returned;

(ii) Identify any evidence on which the guaranty agency bases its position that Federal funds or assets need not be returned;

(iii) Include copies of the documents that contain this evidence;

(iv) Include any arguments that the guaranty agency believes support its position that Federal funds or assets need not be returned; and

(v) Identify the steps taken by the guaranty agency to comply with the requirements referred to in paragraph (c)(2)(v) of this section.

(5)(i) In its appeal, the guaranty agency may request the opportunity to make an oral argument to the deciding official for the purpose of clarifying any issues raised by the appeal. The deciding official provides this opportunity promptly after the expiration of the period referred to in paragraph (d)(2) of this section.

(ii) The agency may not submit new evidence at or after the oral argument unless the deciding official determines otherwise. A transcript of the oral argument is made a part of the record of the appeal and is promptly provided to the agency.

(6) The guaranty agency has the burden of production and the burden of persuading the deciding official that the Secretary's determination should be modified or withdrawn.

(e) *Third-party participation.*

(1) If the Secretary issues a determination under paragraph (a)(1) of this section, the Secretary promptly publishes a notice in the **Federal Register** announcing the portion of the Federal Fund to be returned by the agency and providing interested persons an opportunity to submit written information relating to the determination within 30 days after the date of publication. The Secretary publishes the notice no earlier than five days after the agency receives a copy of the determination.

(2) If the guaranty agency to which the determination relates files a notice of appeal of the determination, the deciding official may consider any information submitted in response to the **Federal Register** notice. All information submitted by a third party is available for inspection and copying at the offices of the Department of Education in Washington, D.C., during normal business hours.

(f) *Adverse information.* If the deciding official considers information in addition to the evidence described in the notice of the Secretary's determination that is adverse to the guaranty agency's position on appeal, the deciding official informs the agency and provides it a reasonable opportunity to respond to the information without regard to the period referred to in paragraph (d)(2) of this section.

(g) *Decision.*

(1) The deciding official issues a written decision on the guaranty agency's appeal within 45 days of the date on which the information described in paragraph (d)(4) and (d)(5)(ii) of this section is received, or the oral argument referred to in paragraph (d)(5) of this section is held, whichever is later. The deciding official mails the decision to the guaranty agency by certified mail, return receipt requested. The decision of the deciding official becomes the final decision of the Secretary 30 days after the deciding official issues it. In the case of a determination that a guaranty agency must return Federal funds, if the deciding official does not issue a decision within the prescribed period, the agency is no longer required to take the actions described in paragraph (c)(2)(v) of this section.

(2) A guaranty agency may not seek judicial review of the Secretary's determination to require the return of

Federal funds or assets until the deciding official issues a decision.

(3) The deciding official's written decision includes the basis for the decision. The deciding official bases the decision only on evidence described in the notice of the Secretary's determination and on information properly submitted and considered by the deciding official under this section. The deciding official is bound by all applicable statutes and regulations and may neither waive them nor rule them invalid.

(h) *Collection of Federal funds or assets.*

(1) If the deciding official's final decision requires the guaranty agency to return Federal funds, or requires the guaranty agency to require the return of Federal funds or assets to the agency or to the Secretary, the decision states a new date for compliance with the decision. The new date is no earlier than the date on which the decision becomes the final decision of the Secretary.

(2) If the guaranty agency fails to comply with the decision, the Secretary may recover the Federal funds from any funds due the agency from the Department without any further notice or procedure and may take any other action permitted or authorized by law to compel compliance.

22. Section 682.418 is amended by revising the heading and paragraph (a)(1), and removing the words "reserve fund" and adding, in their place, the words "Operating Fund", respectively, wherever they appear. The revised heading and text follows:

**§ 682.418 Prohibited uses of the assets of the Operating Fund during periods in which the Operating Fund contains transferred funds owed to the Federal Fund.**

(a) \* \* \*

(1) During periods in which the Operating Fund contains transferred funds owed to the Federal Fund, a guaranty agency may not use the assets of the Operating Fund to pay costs prohibited under paragraph (b) of this section and may not use the assets of the Operating Fund to pay for goods, property, or services provided by an affiliated organization unless the agency applies and demonstrates to the Secretary, and receives the Secretary's approval, that the payment would be in the Federal fiscal interest and would not exceed the affiliated organization's actual and reasonable cost of providing those goods, property, or services.

\* \* \* \* \*

23. A new § 682.419 is added to subpart D to read as follows:

**§ 682.419 Guaranty agency Federal Fund.**

(a) *Establishment and control.* A guaranty agency must establish and maintain a Federal Student Loan Reserve Fund (referred to as the "Federal Fund") to be used only as permitted under paragraph (c) of this section. The assets of the Federal Fund and the earnings on those assets are, at all times, the property of the United States. Consequently, the guaranty agency must exercise the level of care required of a fiduciary charged with the duty of protecting, investing, and administering the money of others.

(b) *Deposits.* The agency must deposit into the Federal Fund—

(1) All funds, securities, and other liquid assets of the reserve fund that existed under § 682.410;

(2) The total amount of insurance premiums collected;

(3) Federal payments for default, bankruptcy, death, disability, closed school, false certification, and other claims;

(4) Federal payments for supplemental preclaims assistance activities performed before October 1, 1998;

(5) 70 percent of administrative cost allowances received on or after October 1, 1998 for loans upon which insurance was issued before October 1, 1998;

(6) All funds received by the guaranty agency from any source on FFEL Program loans on which a claim has been paid, minus the portion the agency is authorized to deposit in its Operating Fund;

(7) Investment earnings on the Federal Fund;

(8) Revenue derived from the Federal portion of a nonliquid asset, in accordance with § 682.420; and

(9) Other funds received by the guaranty agency from any source that are specifically designated for deposit in the Federal Fund.

(c) *Uses.* A guaranty agency may use the assets of the Federal Fund only—

(1) To pay insurance claims;

(2) To transfer default aversion fees to the agency's Operating Fund;

(3) To transfer account maintenance fees to the agency's Operating Fund, if directed by the Secretary;

(4) To refund payments made by or on behalf of a borrower on a loan that has been discharged in accordance with § 682.402;

(5) To pay the Secretary's share of borrower payments, in accordance with § 682.404(g);

(6) For transfers to the agency's Operating Fund, pursuant to § 682.421;

(7) To refund insurance premiums related to loans cancelled or refunded, in whole or in part;

(8) To return to the Secretary portions of the Federal Fund required to be returned by the HEA; and

(9) For any other purpose authorized by the Secretary.

(d) *Prohibition against prepayment.* A guaranty agency may not prepay obligations of the Federal Fund unless it demonstrates, to the satisfaction of the Secretary, that the prepayment is in the best interests of the United States.

(e) *Minimum Federal Fund level.* The guaranty agency must maintain a minimum Federal Fund level equal to at least 0.25 percent of its insured original principal amount of loans outstanding.

(f) *Definitions.* For purposes of this section—

(1) *Federal Fund level* means the total of Federal Fund assets identified in paragraph (b) of this section plus the amount of funds transferred from the Federal Fund that are in the Operating Fund, using an accrual basis of accounting.

(2) *Original principal amount of loans outstanding* means—

(i) The sum of—

(A) The original principal amount of all loans guaranteed by the agency; and

(B) The original principal amount of any loans on which the guarantee was transferred to the agency from another guarantor, excluding loan guarantees transferred to another agency pursuant to a plan of the Secretary in response to the insolvency of the agency;

(ii) Minus the original principal amount of all loans on which—

(A) The loan guarantee was cancelled;

(B) The loan guarantee was transferred to another agency;

(C) Payment in full has been made by the borrower;

(D) Reinsurance coverage has been lost and cannot be regained; and

(E) The agency paid claims.

(Authority: 20 U.S.C. 1072-1)

24. A new § 682.420 is added to subpart D to read as follows:

**§ 682.420 Federal nonliquid assets.**

(a) *General.* The Federal portion of a nonliquid asset developed or purchased in whole or in part with Federal reserve funds, regardless of who held or controlled the Federal reserve funds or assets, is the property of the United States. The ownership of that asset must be prorated based on the percentage of the asset developed or purchased with Federal reserve funds. In maintaining and using the Federal portion of a nonliquid asset under this section, the guaranty agency must exercise the level of care required of a fiduciary charged with protecting, investing, and administering the property of others.

(b) *Treatment of revenue derived from a nonliquid Federal asset.* If a guaranty agency derives revenue from the Federal portion of a nonliquid asset, including its sale or lease, the agency must promptly deposit the percentage of the net revenue received into the Federal Fund equal to the percentage of the asset owned by the United States.

(c) *Guaranty agency use of the Federal portion of a nonliquid asset.*

(1) If a guaranty agency uses the Federal portion of a nonliquid asset (other than an intangible or intellectual property asset or a tangible asset of nominal value), the agency must promptly deposit into the Federal Fund an amount representing the net fair value of the use of the asset.

(2) Payments to the Federal Fund required by paragraph (c)(1) of this section must be made not less frequently than quarterly.

(Authority: 20 U.S.C. 1072-1)

25. A new § 682.421 is added to subpart D to read as follows:

**§ 682.421 Funds Transferred from the Federal Fund to the Operating Fund by a Guaranty Agency**

(a) *General.* In accordance with this section, a guaranty agency may request the Secretary's permission to transfer a limited amount of funds from the Federal Fund to the Operating Fund. Upon receiving the Secretary's approval, the agency may transfer the requested funds at any time within 6 months following the date specified by the Secretary. If the Secretary has not approved or disapproved the agency's request within 30 days after receiving it, the agency may transfer the requested funds at any time within the 6 month period beginning on the 31st day after the Secretary received the agency's request. The transferred funds may be used only as permitted by §§ 682.410(a)(2) and 682.418.

(b) *Transferring the principal balance of the Federal Fund.*

(1) *Amount that may be transferred.*

Upon receiving the Secretary's approval, an agency may transfer an amount up to the equivalent of 180 days of cash expenses for purposes allowed by §§ 682.410(a)(2) and 682.418 (not including claim payments) for normal operating expenses to be deposited into the agency's Operating Fund. The amount transferred and outstanding at any time during the first 3 years after establishing the Operating Fund may not exceed the lesser of 180 days cash expenses for purposes allowed by §§ 682.410(a)(2) and 682.418 (not including claim payments), or 45 percent of the balance in the Federal

reserve fund that existed under § 682.410 as of September 30, 1998.

(2) *Requirements for requesting a transfer.* A guaranty agency that wishes to transfer principal from the Federal Fund must provide the Secretary with a proposed repayment schedule and evidence that it can repay the transfer according to its proposed schedule. The agency must provide the Secretary with the following—

(i) A request for the transfer that specifies the desired amount, the date the funds will be needed, and the agency's proposed terms of repayment;

(ii) A projected revenue and expense statement, to be updated annually during the repayment period, that demonstrates that the agency will be able to repay the transferred amount within the repayment period requested by the agency; and

(iii) Certifications by the agency that during the period while the transferred funds are outstanding—

(A) Sufficient funds will remain in the Federal Fund to pay lender claims during the period the transferred funds are outstanding;

(B) The agency will be able to meet the reserve recall requirements of section 422 of the HEA;

(C) The agency will be able to meet the statutory minimum reserve level of 0.25 percent, as mandated by section 428(c)(9) of the HEA; and

(D) No legal prohibition exists that would prevent the agency from obtaining or repaying the transferred funds.

(c) *Transferring interest earned on the Federal Fund.*

(1) *Amount that may be transferred.* The Secretary may permit an agency that owes the Federal Fund the maximum amount allowable under paragraph (b) of this section to transfer the interest income earned on the Federal Fund during the three-year period following October 7, 1998. The combined amount of transferred interest and the amount of principal transferred under paragraph (b) of this section may exceed 180 days cash expenses for purposes allowed by §§ 682.410(a)(2) and 682.418 (not including claim payments), but may not exceed 45 percent of the balance in the Federal reserve fund that existed under § 682.410 as of September 30, 1998.

(2) *Requirements for requesting a transfer.* To be allowed to transfer the interest income, in addition to the items in paragraph (b)(2) of this section, the agency must demonstrate to the Secretary that the cash flow in the Operating Fund will be negative if the agency is not authorized to transfer the interest, and by transferring the interest,

the agency will substantially improve its financial circumstances.

(Authority: 20 U.S.C. 1072-1)

26. A new § 682.422 is added to subpart D to read as follows:

**§ 682.422 Guaranty agency repayment of funds transferred from the Federal Fund.**

(a) *General.* A guaranty agency must begin repayment of money transferred from the Federal Fund not later than the start of the 4th year after the agency establishes its Operating Fund. All amounts transferred must be repaid not later than five years after the date the Operating Fund is established.

(b) *Extension for repaying the interest transferred.*

(1) *General.* The Secretary may extend the period for repayment of interest transferred from the Federal Fund from two years to five years if the Secretary determines that the cash flow of the Operating Fund will be negative if the transferred interest had to be repaid earlier or the repayment of the interest would substantially diminish the financial circumstances of the agency.

(2) *Agency eligibility for an extension.* To receive an extension, the agency must demonstrate that it will be able to repay all transferred funds by the end of the 8th year following the date of establishment of the Operating Fund and that the agency will be financially sound upon the completion of repayment.

(3) *Repayment of interest earned on transferred funds.* If the Secretary extends the period for repayment of interest transferred from the Federal Fund for a guaranty agency, the agency must repay the amount of interest during the 6th, 7th, and 8th years following the establishment of the Operating Fund. In addition to repaying the amount of interest, the guaranty agency must also pay to the Secretary any income earned after the 5th year from the investment of the transferred amount. In determining the amount of income earned on the transferred amount, the Secretary will use the average investment income earned on the agency's Operating Fund.

(c) *Consequences if a guaranty agency fails to repay transfers from the Federal Fund.* If a guaranty agency fails to make a scheduled repayment to the Federal Fund, the agency may not receive any other Federal funds until it becomes current in making all scheduled payments, unless the Secretary waives this restriction.

(Authority: 20 U.S.C. 1072-1)

27. A new § 682.423 is added to subpart D to read as follows:

**§ 682.423 Guaranty Agency Operating Fund.**

(a) *Establishment and control.* A guaranty agency must establish and maintain an Operating Fund in an account separate from the Federal Fund. Except for funds that have been transferred from the Federal Fund, the Operating Fund is considered the property of the guaranty agency. During periods in which the Operating Fund contains funds transferred from the Federal Fund, the Operating Fund may be used only as permitted by §§ 682.410(a)(2) and 682.418.

(b) *Deposits.* The guaranty agency must deposit into the Operating Fund—

(1) Amounts authorized by the Secretary to be transferred from the Federal Fund;

(2) Account maintenance fees;

(3) Loan processing and issuance fees;

(4) Default aversion fees;

(5) 30 percent of administrative cost allowances received on or after October 1, 1998 for loans upon which insurance was issued before October 1, 1998;

(6) The portion of the amounts collected on defaulted loans that remains after the Secretary's share of collections has been paid and the complement of the reinsurance percentage has been deposited into the Federal Fund;

(7) The agency's share of the payoff amounts received from the consolidation or rehabilitation of defaulted loans; and

(8) Other receipts as authorized by the Secretary.

(c) *Uses.* A guaranty agency may use the Operating Fund for—

(1) Guaranty agency related activities, including—

(i) Application processing;

(ii) Loan disbursement;

(iii) Enrollment and repayment status management;

(iv) Default aversion activities;

(v) Default collection activities;

(vi) School and lender training;

(vii) Financial aid awareness and related outreach activities; and

(viii) Compliance monitoring; and

(2) Other student financial aid-related activities for the benefit of students, as selected by the guaranty agency.

(Authority: 20 U.S.C. 1072-2)

**Subpart H—[Amended]**

28. Subpart H is amended as follows by:

A. Removing §§ 682.800 through 682.839.

B. Redesignating § 682.840 as § 682.800.

C. Removing the term "handicapped status" in the redesignated § 682.800(a)

and adding "disability status" in its place.

\* \* \* \* \*

29. Appendix D to part 682 is revised to read as follows:

**Appendix D to Part 682—Policy for Waiving the Secretary's Right to Recover or Refuse to Pay Interest Benefits, Special Allowance, and Reinsurance on Stafford, Plus, Supplemental Loans for Students, and Consolidation Program Loans Involving Lenders' Violations of Federal Regulations Pertaining to Due Diligence in Collection or Timely Filing of Claims [Bulletin 88-G-138].**

**Note:** The following is a reprint of Bulletin 88-G-138, issued on March 11, 1988, with modifications made to reflect changes in the program regulations. For a loan that has lost reinsurance prior to December 1, 1992, this policy applies only through November 30, 1995. For a loan that loses reinsurance on or after December 1, 1992, this policy applies until three years after the default claim filing deadline. For the purpose of determining the three-year deadline, reinsurance is lost on the later of (a) three years from the last date the claim could have been filed for claim payment with the guaranty agency (271st or 331st day of delinquency, as applicable) for a claim that was not filed; or (b) three years from the date the guaranty agency rejected the claim, for a claim that was filed. These deadlines are extended by periods during which the court imposes a stay of collection activities due to the borrower's filing a bankruptcy petition.

**Introduction**

This letter sets forth the circumstances under which the Secretary, pursuant to sections 432(a)(5) and (6) of the Higher Education Act of 1965 and 34 CFR 682.406(b) and 682.413(f), will waive certain of the Secretary's rights and claims with respect to Stafford Loans, PLUS, Supplemental Loans for Students (SLS), and Consolidation Program loans made under a guaranty agency program that involve violations of Federal regulations pertaining to due diligence in collection or timely filing. (These programs are collectively referred to in this letter as the FFEL Program.) This policy applies to due diligence violations on loans for which the first day of delinquency occurred on or after March 10, 1987 (the effective date of the November 10, 1986 due diligence regulations) and to timely filing violations occurring on or after December 26, 1986, whether or not the affected loans have been submitted as claims to the guaranty agency.

The Secretary has been implementing a variety of regulatory and administrative actions to minimize defaults in the FFEL Program. As a part of this effort, the Secretary published final regulations on November 10, 1986, requiring lenders and guaranty agencies to undertake specific due diligence activities to collect delinquent and defaulted loans, and establishing deadlines for the filing of claims by lenders with guaranty agencies. In recognition of the time required

for agencies and lenders to modify their internal procedures, the Secretary delayed for four months the date by which lenders were required to comply with the new due diligence requirements. Thus, § 682.411 of the regulations, which established minimum due diligence procedures that a lender must follow in order for a guaranty agency to receive reinsurance on a loan, became effective for loans for which the first day of delinquency occurred on or after March 10, 1987. The regulations make clear that compliance with these minimum requirements, and with the new timely filing deadlines, is a condition for an agency's receiving or retaining reinsurance payments made by the Secretary on a loan. See 34 CFR 682.406(a)(3), (a)(5), (a)(6) and 682.413(b). The regulations also specify that a lender must comply with § 682.411 and with the applicable filing deadline as a condition for its right to receive or retain interest benefits and special allowance on a loan for certain periods. See 34 CFR 682.300(b)(2)(vi), 682.300(b)(2)(vii), 682.413(a)(1).

The Department has received inquiries regarding the procedures by which a lender may cure a violation of § 682.411 regarding diligent loan collection, or of the 90-day deadline for the filing of default claims found in § 682.406(a)(3) and (a)(5), in order to reinstate the agency's right to reinsurance and the lender's right to interest benefits and special allowance. Preliminarily, please note that, absent an exercise of the Secretary's waiver authority, a guaranty agency may not receive or retain reinsurance payments on a loan on which the lender has violated the Federal due diligence or timely filing requirements, even if the lender has followed a cure procedure established by the agency. Under §§ 682.406(b) and 682.413(f), the Secretary—not the guaranty agency—decides whether to reinstate reinsurance coverage on a loan involving such a violation or any other violation of Federal regulations. A lender's violation of a guaranty agency's requirement that affects the agency's guarantee coverage also affects reinsurance coverage. See §§ 682.406(a)(7) and 682.413(b). As §§ 682.406(a)(7) and 682.413(b) make clear, a guaranty agency's cure procedures are relevant to reinsurance coverage only insofar as they allow for cure of violations of requirements established by the agency affecting the loan insurance it provides to lenders. In addition, all those requirements must be submitted to the Secretary for review and approval under 34 CFR 682.401(d).

References throughout this letter to "due diligence and timely filing" rules, requirements, and violations should be understood to mean only the Federal rules cited above, unless the context clearly requires otherwise.

**A. Scope**

This letter outlines the Secretary's waiver policy regarding certain violations of Federal due diligence or timely filing requirements on a loan insured by a guaranty agency. Unless your agency receives notification to the contrary, or the lender's violation involves fraud or other intentional misconduct, you may treat as reinsured any otherwise reinsured loan involving such a

violation that has been cured in accordance with this letter.

**B. Duty of a Guaranty Agency to Enforce Its Standards**

As noted above, a lender's violation of a guaranty agency's requirement that affects the agency's guarantee coverage also affects reinsurance coverage. Thus, as a general rule, an agency that fails to enforce such a requirement and pays a default claim involving a violation is not eligible to receive reinsurance on the underlying loan. However, in light of the waiver policy outlined below, which provides more stringent cure procedures for violations occurring on or after May 1, 1988 than for pre-May 1, 1988 violations, some guaranty agencies with more stringent policies than the policy outlined below for the pre-May 1 violations have indicated that they wish to relax their own policies for violations of agency rules during that period. While the Secretary does not encourage any agency to do so, the Secretary will permit an agency to take either of the following approaches to its enforcement of its own due diligence and timely filing rules for violations occurring before May 1, 1988.

(1) The agency may continue to enforce its rules, even if they result in the denial of guarantee coverage by the agency on otherwise reinsurable loans; or

(2) The agency may decline to enforce its rules as to any loan that would be reinsured under the retrospective waiver policy outlined below. In other words, for violations of a guaranty agency's due diligence and timely filing rules occurring before May 1, 1988, a guaranty agency is authorized, but not required, to retroactively revise its own due diligence and timely filing standards to treat as guaranteed any loan amount that is reinsured under the retrospective enforcement policy outlined in section I.C.1. However, for any violation of an agency's due diligence or timely filing rules occurring on or after May 1, 1988, the agency must resume enforcing those rules in accordance with their terms, in order to receive reinsurance payments on the underlying loan. For these post-April 30 violations, and for any other violation of an agency's rule affecting its guarantee coverage, the Secretary will treat as reinsured all loans on which the agency has engaged in, and documented, a case-by-case exercise of reasonable discretion allowing for guarantee coverage to be continued or reinstated notwithstanding the violation. But any agency that otherwise fails, or refuses, to enforce such a rule does so without the benefit of reinsurance coverage on the affected loans, and the lenders continue to be ineligible for interest benefits and special allowance thereon.

**C. Due Diligence**

Under 34 CFR 682.200, default on a FFEL Program loan occurs when a borrower fails to make a payment when due, provided this failure persists for 270 days for loans payable in monthly installments, or for 330 days for loans payable in less frequent installments. The 270/330-day default period applies regardless of whether payments were missed consecutively or intermittently. For example,



if the borrower, on a loan payable in monthly installments, makes his January 1st payment on time, his February 1st payment two months late (April 1st), his March 1st payment three months late (June 1st), and makes no further payments, the delinquency period begins on February 2nd, with the first delinquency, and default occurs on December 27th, when the April payment becomes 270 days past due. The lender must treat the payment made on April 1st as the February 1st payment, since the February 1st payment had not been made prior to that time. Similarly, the lender must treat the payment made on June 1st as the March 1st payment, since the March payment had not been made prior to that time.

**Note:** Lenders are strongly encouraged to exercise forbearance, prior to default, for the benefit of borrowers who have missed payments intermittently but have otherwise indicated willingness to repay their loans. See 34 CFR 682.211. The forbearance process helps to reduce the incidence of default, and serves to emphasize for the borrower the importance of compliance with the repayment obligation.

#### D. Timely Filing

The 90-day filing period applicable to FFEL Program default claims is described in 34 CFR 682.406(a)(5). The 90-day filing period begins at the end of the 270/330-day default period. The lender ordinarily must file a default claim on a loan in default by the end of the filing period. However, the lender may, but need not, file a claim on that loan before the 360th day of delinquency (270-day default period plus 90-day filing period) if the borrower brings the account less than 270 days delinquent before the 360th day. Thus, in the above example, if the borrower makes the April 1st payment on December 28th, that payment makes the loan 241 days delinquent, and the lender may, but need not, file a default claim on the loan at that time. If, however, the loan again becomes 270 days delinquent, the lender must file a default claim within 90 days thereafter (unless the loan is again brought to less than 270 days delinquent prior to the end of that 90-day period). In other words, the Secretary will permit a lender to treat payments made during the filing period as curing the default if those payments are sufficient to make the loan less than 270 days delinquent.

Section I of this letter outlines the Secretary's waiver policy for due diligence and timely filing violations. As noted above, to the extent that it results in the imposition of a lesser sanction than that available to the Secretary by statute or regulation, this policy reflects the exercise of the Secretary's authority to waive the Secretary's rights and claims in this area. Section II discusses the issue of the due date of the first payment on a loan and the application of the waiver policy to that issue. Section III provides guidance on several issues related to due diligence and timely filing as to which clarification has been requested by some program participants.

### I. Waiver Policy

#### A. Definitions

The following definitions apply to terms used throughout this letter:

**Full payment** means payment by the borrower, or another person (other than the lender) on the borrower's behalf, in an amount at least as great as the monthly payment amount required under the existing terms of the loan, exclusive of any forbearance agreement in force at the time of the default. (For example, if the original repayment schedule or agreement called for payments of \$50 per month, but a forbearance agreement was in effect at the time of default that allowed the borrower to pay \$25 per month for a specified time, and the borrower defaulted in making the reduced payments, a full payment would be \$50, or two \$25 payments in accordance with the original repayment schedule or agreement.) In the case of a payment made by cash, money order, or other means that do not identify the payor that is received by a lender after the date of this letter, that payment may constitute a full payment only if a senior officer of the lender or servicing agent certifies that the payment was not made by or on behalf of the lender or servicing agent.

**Earliest unexcused violation** means:

(a) In cases when reinsurance is lost due to a failure to timely establish a first payment due date, the earliest unexcused violation would be the 46th day after the date the first payment due date should have been established.

(b) In cases when reinsurance is lost due to a gap of 46 days, the earliest unexcused violation date would be the 46th day following the last collection activity.

(c) In cases when reinsurance is lost due to three or more due diligence violations of 6 days or more, the earliest unexcused violation would be the day after the date of default.

(d) In cases when reinsurance is lost due to a timely filing violation, the earliest unexcused violation would be the day after the filing deadline.

**Reinstatement** with respect to reinsurance coverage means the reinstatement of the guaranty agency's right to receive reinsurance payments on the loan after the date of reinstatement. Upon reinstatement of reinsurance, the borrower regains the right to receive forbearance or deferments, as appropriate. Reinstatement with respect to reinsurance on a loan also includes reinstatement of the lender's right to receive interest and special allowance payments on that loan.

**Gap in collection activity** on a loan means:

(a) The period between the initial delinquency and the first collection activity;

(b) The period between collection activities (a request for preclaims assistance is considered a collection activity);

(c) The period between the last collection activity and default; or

(d) The period between the date a lender discovers a borrower has "skipped" and the lender's first skip-tracing activity.

**Note:** The concept of "gap" is used herein simply as one measure of collection activity.

This definition applies to loans subject to the FFEL and PLUS programs regulations published on or after November 10, 1986. For those loans, not all gaps are violations of the due diligence rules.

**Violation** with respect to the due diligence requirements in § 682.411 means the failure to timely complete a required diligent phone contact effort, the failure to timely send a required letter (including a request for preclaims assistance), or the failure to timely engage in a required skip-tracing activity. If during the delinquency period a gap of more than 45 days occurs (more than 60 days for loans with a transfer), the lender must satisfy the requirement outlined in I.D.1. for reinsurance to be reinstated. The day after the 45-day gap (or 60 for loans with a transfer) will be considered the date that the violation occurred.

**Transfer** means any action, including, but not limited to, the sale of the loan, that results in a change in the system used to monitor or conduct collection activity on a loan from one system to another.

#### B. General

##### 1. Resumption of Interest and Special Allowance Billing on Loans Involving Due Diligence or Timely Filing Violations

For any loan on which a cure is required under this letter in order for the agency to receive any reinsurance payment, the lender may resume billing for interest and special allowance on the loan only for periods following its completion of the required cure procedure.

##### 2. Reservation of the Secretary's Right to Strict Enforcement

While this letter describes the Secretary's general waiver policy, the Secretary retains the option of refusing to permit or recognize cures, or of insisting on strict enforcement of the remedies established by statute or regulation, in cases where, in the Secretary's judgment, a lender has committed an excessive number of severe violations of due diligence or timely filing rules and in cases where the best interests of the United States otherwise require strict enforcement. More generally, this bulletin states the Secretary's general policy and is not intended to limit in any way the authority and discretion afforded the Secretary by statute or regulation.

##### 3. Interest, Special Allowance, and Reinsurance Repayment Required as a Condition for Exercise of the Secretary's Waiver Authority

The Secretary's waiver of the right to recover or refuse to pay reinsurance, interest benefits, or special allowance payments, and recognition of cures for due diligence and timely filing violations, are conditioned on the following:

(1) The guaranty agency and lender must ensure that the lender repays all interest benefits and special allowance received on loans involving violations occurring prior to May 1, 1988, for which the lender is ineligible under the waiver policy for the "retrospective period" described in section I.C.1., or under the waiver policy for timely filing violations described in section I.E.1., by an adjustment to one of the next three

quarterly billings for interest benefits and special allowance submitted by the lender in a timely manner after May 1, 1988. The guaranty agency's responsibility in this regard is satisfied by receipt of a certification from the lender that this repayment has been made in full.

(2) The guaranty agency, on or before October 1, 1988, must repay all reinsurance received on loans involving violations occurring prior to May 1, 1988, for which the agency is ineligible under the waiver policy for the "retrospective period" described in section I.C.1., or under the waiver policy for timely filing violations described in section I.E.1. Pending completion of the repayment described above, a lender or guaranty agency may submit billings to the Secretary on loans that are eligible for reinsurance under the waiver policy in this letter until it learns that repayment in full will not be made, or until the deadline for a repayment has passed without it being made, whichever is earlier. Of course, a lender or guaranty agency is prohibited from billing the Secretary for program payments on any loan amount that is not eligible for reinsurance under the waiver policy outlined in this letter. In addition to the repayments required above, any amounts received in the future in violation of this prohibition must immediately be repaid to the Secretary.

#### 4. Applicability of the Waiver Policy to Particular Classes of Loans

The policy outlined in this letter applies only to a loan for which the first day of the 180/240-day or 270/330-day default period (as applicable) that ended with default by the borrower occurred on or after March 10, 1987, or, in the case of a timely filing violation, December 26, 1986, and that involves violations only of the due diligence or timely filing requirements or both. For a loan that has lost reinsurance prior to December 1, 1992, this policy applies only through November 30, 1995. For a loan that loses reinsurance on or after December 1, 1992, this policy applies until three years after the default claim filing deadline.

#### 5. Excuse of Certain Due Diligence Violations

Except as noted in section II, if a loan has due diligence violations but was later cured and brought current, those violations will not be considered in determining whether a loan was serviced in accordance with 34 CFR 682.411. Guarantors must review the due diligence for the 180 or 270-day period prior to the default date ensuring the due date of the first payment not later made is the correct payment due date for the borrower.

#### 6. Excuse of Timely Filing Violations Due to Performance of a Guaranty Agency's Cure Procedures

If, prior to May 1, 1988, and prior to the filing deadline, a lender commenced the performance of collection activities specifically required by the guaranty agency to cure a due diligence violation on a loan, the Secretary will excuse the lender's timely filing violation if the lender completes the additional activities within the time period permitted by the guaranty agency and files a default claim on the loan not more than 45 days after completing the additional activities.

#### 7. Treatment of Accrued Interest on "Cured" Claims

For any loan involving any violation of the due diligence or timely filing rules for which a "cure" is required under section I.C. or I.E., for the agency to receive a reinsurance payment, the Secretary will not reimburse the guaranty agency for any unpaid interest accruing after the date of the earliest unexcused violation occurring after the last payment received before the cure is accomplished, and prior to the date of reinstatement of reinsurance coverage. The lender may capitalize unpaid interest accruing on the loan from the date of the earliest unexcused violation to the date of the reinstatement of reinsurance coverage. However, if the agency later files a claim for reinsurance on that loan, the agency must deduct this capitalized interest from the amount of the claim. Some cures will not reinstate coverage. For treatment of accrued interest in those cases, see section I.E.1.c.

#### C. Waiver Policy for Violations of the Federal Due Diligence in Collection Requirements (34 CFR 682.411)

A violation of the due diligence in collection rules occurs when a lender fails to meet the requirements found in 34 CFR 682.411. However, if a lender makes all required calls and sends all required letters during any of the delinquency periods described in that section, the lender is considered to be in compliance with that section for that period, even if the letters were sent before the calls were made. The special provisions for transfers apply whenever the violation(s) and, if applicable, the gap, were due to a transfer, as defined in section I.A.

##### 1. Retrospective Period

For one or more due diligence violations occurring during the period March 10, 1987–April 30, 1988—

a. There will be no reduction or recovery by the Secretary of payments to the lender or guaranty agency if no gap of 46 days or more (61 days or more for a transfer) exists.

b. If a gap of 46–60 days (61–75 days for a transfer) exists, principal will be reinsured, but accrued interest, interest benefits, and special allowance otherwise payable by the Secretary for the delinquency period are limited to amounts accruing through the date of default.

c. If a gap of 61 days or more (76 days or more for a transfer) exists, the borrower must be located after the gap, either by the agency or the lender, in order for reinsurance on the loan to be reinstated. (See section I.E.1.d., for a description of acceptable evidence of location.) In addition, if the loan is held by the lender or after March 15, 1988, the lender must follow the steps described in section I.E.1., or receive a full payment or a new signed repayment agreement, in order for the loan to again be eligible for reinsurance. The lender must repay all interest benefits and special allowance received for the period beginning with its earliest unexcused violation, occurring after the last payment received before the cure is accomplished, and ending with the date, if any, that reinsurance on the loan is reinstated.

##### 2. Prospective Period

For due diligence violations occurring on or after May 1, 1988 based on due dates prior to October 6, 1998—

a. There will be no reduction or recovery by the Secretary of payments to the lender or guaranty agency if there is no violation of Federal requirements of 6 days or more (21 days or more for a transfer.)

b. If there exist not more than two violations of 6 days or more each (21 days or more for a transfer), and no gap of 46 days or more (61 days or more for a transfer) exists, principal will be reinsured, but accrued interest, interest benefits, and special allowance otherwise payable by the Secretary for the delinquency period will be limited to amounts accruing through the date of default.

However, the lender must complete all required activities before the claim filing deadline, except that a preclaims assistance request must be made before the 240th day of delinquency. If the lender fails to make this request by the 240th day, the Secretary will not pay any accrued interest, interest benefits, and special allowance for the most recent 180 days prior to default. If the lender fails to complete any other required activity before the claim filing deadline, accrued interest, interest benefits, and special allowance otherwise payable by the Secretary for the delinquency period will be limited to amounts accruing through the 90th day before default.

c. If there exist three violations of 6 days or more each (21 days or more for a transfer) and no gap of 46 days or more (61 days or more for a transfer), the lender must satisfy the requirements outlined in I.E.1., or receive a full payment or a new signed repayment agreement in order for reinsurance on the loan to be reinstated. The Secretary does not pay any interest benefits or special allowance for the period beginning with the lender's earliest unexcused violation occurring after the last payment received before the cure is accomplished, and ending with the date, if any, that reinsurance on the loan is reinstated.

d. If there exist more than three violations of 6 days or more each (21 days or more for a transfer) of any type, or a gap of 46 days (61 days for a transfer) or more and at least one violation, the lender must satisfy the requirement outlined in section I.D.1., for reinsurance on the loan to be reinstated. The Secretary does not pay any interest benefits or special allowance for the period beginning with the lender's earliest unexcused violation occurring after the last payment received before the cure is accomplished, and ending with the date, if any, that reinsurance on the loan is reinstated.

##### 3. Post 1998 Amendments

For due diligence violations based on due dates on or after October 6, 1998—

a. There will be no reduction or recovery by the Secretary of payments to the lender or guaranty agency if there is no violation of Federal requirements of 6 days or more (21 days or more for a transfer.)

b. If there exist not more than two violations of 6 days or more each (21 days or more for a transfer), and no gap of 46 days or more (61 days or more for a transfer)

exists, principal will be reinsured, but accrued interest, interest benefits, and special allowance otherwise payable by the Secretary for the delinquency period will be limited to amounts accruing through the date of default.

However, the lender must complete all required activities before the claim filing deadline, except that a default aversion assistance request must be made before the 330th day of delinquency. If the lender fails to make this request by the 330th day, the Secretary will not pay any accrued interest, interest benefits, and special allowance for the most recent 270 days prior to default. If the lender fails to complete any other required activity before the claim filing deadline, accrued interest, interest benefits, and special allowance otherwise payable by the Secretary for the delinquency period will be limited to amounts accruing through the 90th day before default.

c. If there exist three violations of 6 days or more each (21 days or more for a transfer) and no gap of 46 days or more (61 days or more for a transfer), the lender must satisfy the requirements outlined in I.E.1. or receive a full payment or a new signed repayment agreement in order for reinsurance on the loan to be reinstated. The Secretary does not pay any interest benefits or special allowance for the period beginning with the lender's earliest unexcused violation occurring after the last payment received before the cure is accomplished, and ending with the date, if any, that reinsurance on the loan is reinstated.

d. If there exist more than three violations of 6 days or more each (21 days or more for a transfer) of any type, or a gap of 46 days (61 days for a transfer) or more and at least one violation, the lender must satisfy the requirement outlined in section I.D.1. for reinsurance on the loan to be reinstated. The Secretary does not pay any interest benefits or special allowance for the period beginning with the lender's earliest unexcused violation occurring after the last payment received before the cure is accomplished, and ending with the date, if any, that reinsurance on the loan is reinstated.

#### *D. Reinstatement of Reinsurance Coverage for Certain Egregious Due Diligence Violations*

##### 1. Cures

In the case of a loan involving violations described in section I.C.2.d. or I.C.3.d., the lender may utilize either of the two procedures described in section I.D.1.a. or I.D.1.b. for obtaining reinstatement of reinsurance coverage on the loan.

a. After the violations occur, the lender obtains a new repayment agreement signed by the borrower. The repayment agreement must comply with the ten-year repayment limitations set out in 34 CFR 682.209(a)(7); or

b. After the violations occur, the lender obtains one full payment. If the borrower later defaults, the guaranty agency must obtain evidence of this payment (e.g., a copy of the check) from the lender.

##### 2. Borrower Deemed Current as of Date of Cure

On the date the lender receives a new signed repayment agreement or the curing

payment under section I.D.1., reinsurance coverage on the loan is reinstated, and the borrower must be deemed by the lender to be current in repaying the loan and entitled to all rights and benefits available to borrowers who are not in default. The lender must then follow the collection and timely filing requirements applicable to the loan.

#### *E. Cures for Timely Filing Violations and Certain Due Diligence Violations*

##### 1. Default Claims

a. *Reinstatement of Insurance Coverage.* Except as noted in section I.B.6., in order to obtain reinstatement of reinsurance coverage on a loan in the case of a timely filing violation, a due diligence violation described in section I.C.2.c. or I.C.3.c., or a due diligence violation described in section I.C.1.c. where the lender holds the loan on or after March 15, 1988, the lender must first locate the borrower after the gap, or after the date of the last violation, as applicable. (See section I.E.1.d. for description of acceptable evidence of location.) Within 15 days thereafter, the lender must send to the borrower, at the address at which the borrower was located, (i) a new repayment agreement, to be signed by the borrower, that complies with the ten-year repayment limitations in 34 CFR 682.209(a)(7), along with (ii) a collection letter indicating in strong terms the seriousness of the borrower's delinquency and its potential effect on his or her credit rating if repayment is not commenced or resumed.

If, within 15 days after the lender sends these items, the borrower fails to make a full payment or to sign and return the new repayment agreement, the lender must, within 5 days thereafter, diligently attempt to contact the borrower by telephone. Within 5–10 days after completing these efforts, the lender must again diligently attempt to contact the borrower by telephone. Finally, within 5–10 days after completing these efforts, the lender must send a forceful collection letter indicating that the entire unpaid balance of the loan is due and payable, and that, unless the borrower immediately contacts the lender to arrange repayment, the lender will be filing a default claim with the guaranty agency.

b. *Borrower Deemed Current Under Certain Circumstances.* If, at any time on or before the 30th day after the lender completes the additional collection efforts described in section I.E.1.a., or the 270th day of delinquency, whichever is later, the lender receives a full payment or a new signed repayment agreement, reinsurance coverage on the loan is reinstated on the date the lender receives the full payment or new agreement. The borrower must be deemed by the lender to be current in repaying the loan and entitled to all rights and benefits available to borrowers who are not in default. In the case of a timely filing violation on a loan for which the borrower is deemed current under this paragraph, the lender is ineligible to receive interest benefits and special allowance accruing from the date of the violation to the date of reinstatement of reinsurance coverage on the loan.

c. *Borrower Deemed in Default Under Certain Circumstances.* If the borrower does

not make a full payment, or sign and return the new repayment agreement, on or before the 30th day after the lender completes the additional collection efforts described in section I.E.1.a., or the 270th day of delinquency, whichever is later, the lender must deem the borrower to be in default. The lender must then file a default claim on the loan, accompanied by acceptable evidence of location (see section I.E.1.d.), within 30 days after the end of the 30-day period.

Reinsurance coverage, and therefore the lender's right to receive interest benefits and special allowance, is not reinstated on a loan involving these circumstances. However, the Secretary will honor reinsurance claims submitted in accordance with this paragraph on the outstanding principal balance of those loans, on unpaid interest as provided in section I.B.7., and for reimbursement of eligible supplemental preclaims assistance costs.

In the case of a timely filing violation on a loan for which the borrower is deemed in default under this paragraph, the lender is ineligible to receive interest benefits and special allowance accruing from the date of the violation.

d. *Acceptable Evidence of Location.* Only the following documentation is acceptable as evidence that the lender has located the borrower:

(1) A postal receipt signed by the borrower not more than 15 days prior to the date on which the lender sent the new repayment agreement, indicating acceptance of correspondence from the lender by the borrower at the address shown on the receipt; or

(2) Documentation submitted by the lender showing—

- (i) The name, identification number, and address of the lender;
- (ii) The name and Social Security number of the borrower; and
- (iii) A signed certification by an employee or agent of the lender, that—

(A) On a specified date, he or she spoke with or received written communication (attached to the certification) from the borrower on the loan underlying the default claim, or a parent, spouse, sibling, roommate, or neighbor of the borrower;

(B) The address and, if available, telephone number of the borrower were provided to the lender in the telephone or written communication; and

(C) In the case of a borrower whose address or telephone number was provided to the lender by someone other than the borrower, the new repayment agreement and the letter sent by the lender pursuant to section I.E.1.a., had not been returned undelivered as of 20 days after the date those items were sent, for due diligence violations described in section I.C.1.c. where the lender holds the loan on the date of this letter, and as of the date the lender filed a default claim on the cured loan, for all other violations.

2. *Death, Disability, and Bankruptcy Claims.* The Secretary will honor a death or disability claim on an otherwise eligible loan notwithstanding the lender's failure to meet the 60-day timely filing requirement (See 34 CFR 682.402(g)(2)(i)). However, the Secretary will not reimburse the guaranty agency if,

before the date the lender determined that the borrower died or was totally and permanently disabled, the lender had violated the Federal due diligence or timely filing requirements applicable to that loan, except in accordance with the waiver policy described above. Interest that accrued on the loan after the expiration of the 60-day filing period remains ineligible for reimbursement by the Secretary, and the lender must repay all interest and special allowance received on the loan for periods after the expiration of the 60-day filing period.

The Secretary has determined that, in the vast majority of cases, the failure of a lender to comply with the timely filing requirement applicable to bankruptcy claims (§ 682.402(e)(2)(ii)) causes irreparable harm to the guaranty agency's ability to contest the discharge of the loan by the court, or to otherwise collect from the borrower. Therefore, the Secretary has decided not to excuse violations of the timely filing requirement applicable to bankruptcy claims, except when the lender can demonstrate that the bankruptcy action has concluded and that the loan has not been discharged in bankruptcy or, if previously discharged, has been the subject of a reversal of the discharge. In that case, the lender must return the borrower to the appropriate status that existed prior to the filing of the bankruptcy claim unless the status has changed due solely to passage of time. In the latter case, the lender must place the borrower in the status that would exist had no bankruptcy claim been filed. If the borrower is delinquent after the loan is determined nondischargeable, the lender should grant administrative forbearance to bring the borrower's account current as provided in 34 CFR 682.211(f)(5). The Secretary will not reimburse the guaranty agency for interest for the period beginning on the filing deadline for the bankruptcy claim and ending when the claim is filed or becomes eligible again for reinsurance.

## II. Due Date of First Payment

Section 682.411(b)(1) refers to the "due date of the first missed payment not later made" as one way to determine the first day of delinquency on a loan. Section 682.209(a)(3) states that, generally, the repayment period on an FFEL Program loan begins some number of months after the month in which the borrower ceases at least half-time study. Where the borrower enters the repayment period with the lender's knowledge, the first payment due date may be set by the lender, provided it falls within a reasonable time after the first day of the month in which the repayment period begins. In this situation, the Secretary generally permits a lender to allow the borrower up to 45 days from the first day of repayment to make the first payment (unless the lender establishes the first day of repayment under § 682.209(a)(3)(ii)(E)).

In cases where the lender learns that the borrower has entered the repayment period after the fact, current § 682.411 treats the 30th day after the lender receives this information as the first day of delinquency. In the course of discussion with lenders, the Secretary has learned that many lenders have not been using the 30th day after receipt of

notice that the repayment period has begun ("the notice") as the first payment due date. In recognition of this apparently widespread practice, the Secretary has decided that, both retrospectively and prospectively, a lender should be allowed to establish a first payment due date within 60 days after receipt of the notice, to capitalize interest accruing up to the first payment due date, and to exercise forbearance with respect to the period during which the borrower was in the repayment period but made no payment. In effect, this means that, if the lender sends the borrower a coupon book, billing notice, or other correspondence establishing a new first payment due date, on or before the 60th day after receipt of the notice, the lender is deemed to have exercised forbearance up to the new first payment due date. The new first payment due date must fall no later than 75 days after receipt of the notice (unless the lender establishes the first day of repayment under § 682.209(a)(3)(ii)(E)). In keeping with the 5-day tolerance permitted under section I.C.2.a., for the "prospective period," or section I.C.3.a., for the "post 1998 amendment period," a lender that sends the above-described material on or before the 65th day after receipt of the notice will be held harmless. However, a lender that does so on the 66th day will have failed by more than 5 days to send both of the collection letters required by § 682.411(c) to be sent within the first 30 days of delinquency and will thus have committed two violations of more than five days of that rule.

If the lender fails to send the material establishing a new first payment due date on or before the 65th day after receipt of the notice, it may thereafter send material establishing a new first payment due date falling not more than 45 days after the materials are sent and will be deemed to have exercised forbearance up to the new first payment due date. However, all violations and gaps occurring prior to the date on which the material is sent are subject to the waiver policies described in section I for violations falling in either the retrospective or prospective periods. This is an exception to the general policy set forth in section I.B.5., that only violations occurring during the most recent 180 or 270 days (as applicable) of the delinquency period on a loan are relevant to the Secretary's examination of due diligence.

**Please Note:** References to the "65th day after receipt of the notice" and "66th day" in the preceding paragraphs should be amended to read "95th day" and "96th day" respectively for lenders subject to § 682.209(a)(3)(ii)(E).

## III. Questions and Answers

The waiver policy outlined in this letter was developed after extensive discussion and consultation with participating lenders and guaranty agencies. In the course of these discussions, lenders and agencies raised a number of questions regarding the due diligence rules as applied to various circumstances. The Secretary's responses to these questions follow.

**Note:** The answer to questions 1 and 4 are applicable only to loans subject to § 682.411 of the FFEL and PLUS program regulations published on or after November 10, 1986.

1. Q: Section 682.411 of the program regulations requires the lender to make "diligent efforts to contact the borrower by telephone" during each 30-day period of delinquency beginning after the 30th day of delinquency. What must a lender do to comply with this requirement?

A: Generally speaking, one actual telephone contact with the borrower, or two attempts to make such contact on different days and at different times, will satisfy the "diligent efforts" requirement for any of the 30-day delinquency periods described in the rule. However, the "diligent efforts" requirement is intended to be a flexible one, requiring the lender to act on information it receives in the course of attempting telephone contact regarding the borrower's actual telephone number, the best time to call to reach the borrower, etc. For instance, if the lender is told during its second telephone contact attempt that the borrower can be reached at another number or at a different time of day, the lender must then attempt to reach the borrower by telephone at that number or that time of day.

2. Q: What must a lender do when it receives conflicting information regarding the date a borrower ceased at least half-time study?

A: A lender must promptly attempt to reconcile conflicting information regarding a borrower's in-school status by making inquiries of appropriate parties, including the borrower's school. Pending reconciliation, the lender may rely on the most recent credible information it has.

3. Q: If a loan is transferred from one lender to another, is the transferee held responsible for information regarding the borrower's status that is received by the transferor but is not passed on to the transferee?

A: No. A lender is responsible only for information received by its agents and employees. However, if the transferee has reason to believe that the transferor has received additional information regarding the loan, the transferee must make a reasonable inquiry of the transferor as to the nature and substance of that information.

4. Q: What are a lender's due diligence responsibilities where a check received on a loan is dishonored by the bank on which it was drawn?

A: Upon receiving notice that a check has been dishonored, the lender must treat the payment as having never been made for purposes of determining the number of days that the borrower is delinquent at that time. The lender must then begin (or resume) attempting collection on the loan in accordance with § 682.411, commencing with the first 30-day delinquency period described in § 682.411 that begins after the 30-day delinquency period in which the notice of dishonor is received. The same result occurs when the lender successfully obtains a delinquent borrower's correct address through skip-tracing, or when a delinquent borrower leaves deferment or forbearance status.

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