

# Default Issues in Detail

## CHAPTER 5

*Since most of your current students will be eligible for in-school deferment if they're attending at least half-time, you are most likely to be involved in default issues with students who have graduated or new students who are applying for aid at your school after having defaulted on a loan at another school.*

*The consequences of default have already been presented as a part of the entrance materials (Chapter 1) and in more detail in the exit materials (Chapter 2). In this chapter, we will focus on information that is relevant to delinquent borrowers and borrowers whose loans have already gone into default.*

*The following fact sheets on default will explain the sequence of steps when a loan goes into default, and how the borrower can get the loan out of default. If the borrower doesn't know who holds the loan, you can assist by looking up the loan information on the National Student Loan Data System. As an alternative, you can suggest that the borrower use the NSLDS Web site (requires a PIN) or call the Federal Student Aid Information Center at 1-800-4 FED AID (requires name, social security number, and date of birth).*

*If the borrower with a defaulted SFA loan is applying for aid at your school, the ISIR will have a comment indicating that the applicant has a defaulted loan. Your school's responsibilities with respect to loan defaults are explained in Volume 1 of the SFA Handbook (Student Eligibility).*

### DEFAULT ISSUES

#### Lender Collections

- Sends letters and makes phone calls for collection
- Lender requests pre-claim assistance from the guaranty agency (60-120 days of delinquency)
- Submits default claim after 270 days

#### Guarantor Collections

- Reports default to credit bureau
- Wage garnishment
- Tax refund offset
- Legal action

#### ED Debt Collection Service

- Collects on loans assigned by guarantor
- Same collection efforts as guarantor

#### Ways to Resolve Default

- Consolidate the defaulted loan
- Make satisfactory arrangements to repay the loan
- Loan rehabilitation





# What Happens When a Loan Goes Into Default

▲ **Delinquency.** If you become delinquent — that is, you don't make a payment when scheduled — your lender will try to contact you by phone and by mail to ask that you bring your payments up-to-date. If your address and phone information is no longer accurate, the servicer or lender will use skip-tracing methods to locate and make contact with you. Your lender is required to report the delinquency to at least one national credit bureau.

▲ **Preclaims assistance from the guarantor.** After the 60th day of delinquency and no later than the 120th day, the lender must request that the loan guarantor provide “default aversion assistance” The guarantor will provide counseling and consumer information to you, including information about preventive measures to avoid default.

▲ **Final demand letter.** If your delinquency persists, the lender is required to send you a “final demand” letter, asking that you pay the entire balance of the loan in one payment.

▲ **Default claim.** If the account is more than 270 days delinquent (or 330 days delinquent for a loan repayable in installments less frequent than monthly), your lender or servicer will submit a default claim to the agency that guaranteed the loan. The guaranty agency will review the lender's collection efforts before paying the default claim.

▲ **Collection by the guarantor.** Once the guaranty agency pays the default claim, it owns the loan and will continue the collection efforts begun by the lender, contacting you through a series of letters and phone calls to make repayment arrangements. The repayment amount will include a mandatory assessment of collection costs. The guarantor may seek to garnish up to 10 percent of your disposable pay, withhold (“offset”) part or all of your federal and/or state income tax refund and other payments that the federal government might otherwise make to you, and file suit against you. There is no statute of limitations on garnishment, offset action, or lawsuits to recover defaulted SFA loans, regardless of any federal or state statutes of limitation that might otherwise have applied to such collection efforts.

▲ **Report to credit bureaus.** The guarantor will send you a written notice before reporting the default to a national credit bureau or assessing collection costs. The notice will include information about making a repayment agreement and give you an opportunity for an administrative review of the status of the loan. The credit bureau may continue to report the default information for up to seven years from the date the loan is first reported as a default (or the date the guaranty agency pays the default claim). If you enter repayment after default and again allow the loan to default, the credit bureau may continue to report the default information for up to seven years from the date the loan enters default the second time.

▲ **Loss of eligibility.** Once you go into default, you lose your eligibility for aid from *any* of the SFA programs, including Pell Grants. You also lose eligibility for any type of deferment on the loan. However, a lender or guarantor may grant forbearance on a delinquent or defaulted loan if you can't make payments.

▲ **Assignment to the Department's Debt Collection Service.** The guarantor may assign your loan to the U.S. Department of Education for collection. The Department's Debt Collection Service will undertake the same collection efforts as described above for the guarantor.



# Resolving Your Default

## Consolidation

One of the quickest ways to regain eligibility for student aid after defaulting on a Stafford or PLUS loan is to consolidate the loan. However, if you consolidate a defaulted loan, it will continue to be listed on your credit record (“defaulted loan, paid in full”). In contrast, if you make 12 consecutive monthly payments, you may be able to rehabilitate your loan (see below) and remove it from default status. For more information on how to consolidate your loans, refer to our fact sheet on loan consolidation.

## Repayment arrangements & rehabilitation

There are other ways to resolve your default status if you can’t consolidate your defaulted loan(s). If you make **satisfactory arrangements to repay** your debt, you may regain eligibility for SFA funds after you make six consecutive on-time monthly payments. (The payments must be voluntary— income tax offset, wage garnishment, or income or asset execution, don’t count.) Reinstatement of eligibility does not bring a loan out of default, and does not restore your rights to in-school and other deferments.

If you’ve made six consecutive payments, the holder of your loan (usually the guaranty agency or the Department’s Debt Collection Service) should inform you of the possibility of **loan rehabilitation**, which has the advantage of bringing your loan out of default. The loan holder is required to provide you with a written statement specifying a reasonable and affordable payment amount (as determined by the loan holder) and must give you an opportunity to object to the terms.

After you make 12 consecutive on-time monthly payments (which may include the six consecutive monthly payments necessary to regain SFA eligibility) the loan holder will decide if you are a good candidate for loan rehabilitation. If the loan holder elects to rehabilitate your loan, it will try to sell the loan to an eligible FFEL lender. If you’ve already made more than 12 consecutive monthly payments at the time you request rehabilitation, you are immediately eligible for consideration. It’s very important that you continue to make payments while the holder of your defaulted loan processes the rehabilitation and transfers the loan to a lender. Because of loan processing procedures, you may have to submit more than 12 payments before the loan is rehabilitated.

Once a loan is rehabilitated, you regain eligibility for any remaining deferment benefits. For example, if you receive an unemployment deferment for one year, go into default, and then rehabilitate the loan, you are eligible for the remaining two years (not another full three) of unemployment deferment.

The guarantor must notify at least one credit bureau of the loan’s rehabilitated status within 90 days of the date of rehabilitation. This is an important advantage of rehabilitation, because it removes the record of default from your credit history. If you have questions about loan rehabilitation, you should contact the agency holding the defaulted loan.

## Regaining eligibility for aid

If you have made satisfactory repayment arrangements to repay a defaulted loan and then submit the *Free Application for Federal Student Aid*, you will get a Student Aid Report (SAR) with a warning that you will only remain eligible for federal student aid if you continue to make scheduled payments on time. If the SAR still shows you to be in default, the financial aid administrator at your school may still award you SFA funds, if the loan holder provides written confirmation that you have made satisfactory arrangements to repay the loan. If you regain eligibility during an enrollment period (if the sixth payment under a satisfactory repayment arrangement is made after the start of an enrollment period, for example), you regain eligibility for the entire period of enrollment (usually an academic year).



# Reference: Special Default Cases

## Uncollectable loans

A loan on which collection activities have ceased after several collection efforts have failed is still considered a defaulted loan for purposes of borrower eligibility. If you want to receive further aid from the SFA programs, you must reaffirm the loan amount and make satisfactory repayment arrangements.

## Compromise agreements

If you reach a compromise agreement with the holder of your loan to settle the debt for less than the total amount due, you may be eligible for additional federal student aid once the compromised amount of the debt is paid.

## Effect of loan cancellation

If a defaulted loan is canceled for reasons such as bankruptcy, school closure, or false certification, the loan is no longer considered to be in default, and you will become eligible for further federal student aid. In addition, any adverse credit history will be deleted from credit bureau records.

If your defaulted loan is canceled because of total and permanent disability, you will be eligible for further loans on a conditional basis. (See our fact sheet on disability cancellations.)

## Loans subject to court judgments

If you want to rehabilitate or consolidate an FFEL on which a court judgment has been secured, you must sign a new promissory note prior to the sale of the FFEL to an eligible lender. (A guaranty agency may not exclude borrowers with judgment accounts from consolidating their defaulted loans.) Because a judgment is not always repaid under the original terms and conditions of the FFEL promissory note, the judgment is not viewed as an eligible FFEL. Therefore, rehabilitation or consolidation of a loan on which a court judgment has been secured requires the guaranty agency to vacate the judgment and to convert the judgment debt into an eligible FFEL. This conversion takes place when you make a new promise to repay the debt by signing an FFEL promissory note for the amount due on the judgment.