

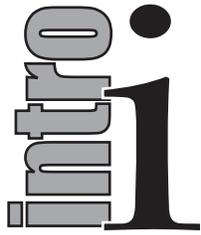
CONTENTS

CHAPTER 11

WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM

INTRODUCTION	1
Recent Changes	2
SECTION 1: ELIGIBILITY	5
Student Borrower Eligibility	5
Parent Borrower Eligibility	8
Eligibility After Bankruptcy Discharge	9
Refusal to Originate a Loan	9
Institutional Eligibility	10
Withdrawing from the Direct Loan Program	12
SECTION 2: DIRECT SUBSIDIZED LOANS, DIRECT UNSUBSIDIZED LOANS, AND DIRECT PLUS LOANS	13
Credit History	13
Loan Limits	14
Prorated Annual Loan Limits—Direct Subsidized and Unsubsidized Loans	19
Frequency of Annual Loan Limits	22
Interest Rates	25
Additional Borrowing Costs	27
Grace Periods—Direct Subsidized and Unsubsidized Loans	28
Repayment	28
Deferment	34
Forbearance	37
Discharge	39
Department of Defense Repayment	41
Borrower Defenses	41
SECTION 3: DIRECT CONSOLIDATION LOANS	43
Types of Direct Consolidation Loans	43
Loan Limits	45
Interest Rates	45
Additional Borrowing Costs	46
Eligibility	47
Subsequent Consolidation	52
Repayment	53
Holder Responsibilities	54

SECTION 4: DEFAULT	57
Default's Effect on Borrowers	57
Default's Effect on Schools	60
 SECTION 5: SCHOOL RESPONSIBILITIES	 71
Determining the Loan Period	71
Disbursements	73
Other School Responsibilities	79



Introduction

The William D. Ford Federal Direct Loan Program (also known as the Direct Loan Program and Direct Loans) was authorized under Title IV of the Higher Education Act with passage of the Student Loan Reform Act of 1993. A major source of federal student assistance, the Direct Loan Program provides loans to eligible borrowers to cover postsecondary education costs. The program uses loan capital the federal government provides, requires only one aid application (the *Free Application for Federal Student Aid*), and makes loans available directly through participating schools rather than through private lenders and guaranty agencies.

The following types of loans are available through the Direct Loan Program:

- ◇ **Federal Direct Stafford/Ford Loans (Direct Subsidized Loans)** are awarded to students who demonstrate financial need. Because the Department subsidizes the interest, borrowers are not charged interest while they are enrolled in school at least half time and during in-school, grace, and deferment periods.
- ◇ **Federal Direct Unsubsidized Stafford/Ford Loans (Direct Unsubsidized Loans)** are awarded to students regardless of financial need. Borrowers are responsible for the interest that accrues during any period.
- ◇ **Federal Direct PLUS Loans (Direct PLUS Loans)** allow parents to borrow on behalf of their dependent undergraduate children who are enrolled at least half time. As with Direct Unsubsidized Loans, borrowers are responsible for the interest that accrues on a Direct PLUS Loan during any period.
- ◇ **Federal Direct Consolidation Loans (Direct Consolidation Loans)** allow any borrower to combine one or more federal education loans into a new Direct Loan.

The main participants in the Direct Loan Program are the borrowers (students and parents), the postsecondary schools, and the U.S. Department of Education (the Department). Each participant has a particular role.

- ◇ **Student borrowers** must complete the *Free Application for Federal Student Aid* (FAFSA), sign a completed promissory note, participate in loan counseling, and repay the loan.
- ◇ **Parent borrowers** must complete and sign the required application/promissory note, meet established credit standards, borrow on behalf of an eligible student, and repay the loan.
- ◇ **Postsecondary schools** must meet and maintain specific eligibility criteria, meet and maintain specific criteria to originate loans, and execute a Program Participation Agreement with the Department. Schools must also certify borrower eligibility and disburse loan funds.
- ◇ **The Department** funds, services, and collects loans; provides support services to schools; and oversees the program.

Basic student and institutional eligibility requirements under the Direct Loan Program are consistent with other Student Financial Assistance (SFA) Programs. In addition, there are similarities, as well as important differences, between the Direct Loan Program and the Federal Family Education Loan (FFEL) Program. Chapter 11 focuses primarily on federal requirements and policies specific to Direct Loans. Chapter 2 covers general student eligibility requirements; Chapter 3 discusses general institutional requirements. For a comparison with the FFEL Program, see Chapter 10.

RECENT CHANGES

There have been a few changes for the Direct Loan Program:

- ◇ The separate application for schools wanting to participate in the Direct Loan Program has been eliminated (see page 11-10).
- ◇ The aggregate loan limit has been increased for certain health professions students (see page 11-19).

Other possible changes were under consideration at the time this Handbook went to print. The Department also expects to issue further guidance on some topics.

- ◇ On September 25, 1997, the Department published a Notice of Proposed Rulemaking that would make changes to the Direct Loan Program regulations. These proposed modifications are intended to eliminate certain differences between the FFEL and Direct Loan programs. At the time this Handbook went to print, the Department expected to publish final regulations by December 1, 1997.
- ◇ The interest rate formula for all Direct Loans is scheduled to change for loans first disbursed on or after July 1, 1998 (see pages 11-26 and 11-44).
- ◇ The Department is planning to provide further guidance on the calculation of cohort default rates when a school changes its status (see page 11-65).

Up-to-date information on these and other topics will be available on the SFA BBS.

Section 1

Eligibility

Direct Loan Program borrowers and schools must meet federal eligibility requirements outlined in the law and regulations. Chapters 2 and 3 provide extensive information about those requirements. This section highlights eligibility information for borrowers and schools.

STUDENT BORROWER ELIGIBILITY

Eligibility for a Direct Subsidized Loan or Direct Unsubsidized Loan requires a student to be enrolled at least half time as a regular student in an eligible program at a school participating in the Direct Loan Program. Students may also obtain Direct Loans while enrolled in a 12-month period of preparatory coursework or in a teacher certification program (see Section 2 for more information).

Although a postsecondary school may participate simultaneously in the Direct Loan and Federal Family Education Loan (FFEL) programs, a student may not borrow from both programs for attendance at the same school for the same enrollment period.

Students without high school diplomas or recognized equivalents may still be academically qualified and, thus, eligible for Direct Loans. Such students must demonstrate the ability to benefit from the instruction being offered. See Chapter 2, Section 1 for detailed information on how the student's ability to benefit is determined.

Incarcerated students and students enrolled in elementary or secondary schools are not eligible for Direct Loans.

Schools that participate in the Federal Pell Grant Program must determine Pell Grant eligibility before awarding Direct Subsidized and Direct Unsubsidized Loans. In addition, before awarding a Direct Unsubsidized Loan, an aid administrator must first determine whether the student is eligible for a lower-cost Direct Subsidized Loan. Note that in general a school can award a Direct PLUS Loan **without** first determining whether the dependent student for whom the parent is borrowing is eligible for a Pell Grant or Direct Subsidized Loan. However, in order to make a late

Enrollment status

No FFELs and Direct Loans for same enrollment period

Federal Pell Grant eligibility

disbursement of a Direct PLUS Loan, the school must have a *Student Aid Report* (SAR) or *Institutional Student Information Record* (ISIR) for the student with an official Expected Family Contribution (EFC).

**Financial
need**

To qualify for a **Direct Subsidized Loan**, a student must have financial need, which is determined by the following formula:

$$\begin{aligned} & \text{Cost of Attendance (COA)} \\ & - \text{Expected Family Contribution (EFC)} \\ & - \text{Estimated Financial Aid (EFA)} \\ & = \text{Eligibility for Direct Subsidized Loans} \end{aligned}$$

The school establishes the COA in compliance with federal guidelines. The EFC is calculated using financial information the student's family provides on the *Free Application for Federal Student Aid* (FAFSA), the only application a student needs to apply for Direct Loans. The EFA includes the amount of the student's Pell Grant eligibility plus other aid the student will actually receive.

Although financial need is not considered when determining the amount of **Direct Unsubsidized Loans** and **Direct PLUS Loans** for which a borrower is eligible, the COA and EFA must be taken into account:

$$\begin{aligned} & \frac{\text{COA}}{\text{EFA}} \\ & = \text{Eligibility for Direct Unsubsidized Loans/Direct PLUS Loans} \end{aligned}$$

Proceeds from Direct Unsubsidized Loans and Direct PLUS Loans may be used to replace the EFC for a given loan period. (The same is true for nonfederal loan proceeds.) See Chapter 2, Section 3 for detailed information about how eligibility for the Direct Loan Program (and the other SFA Programs) is determined using the COA, EFC, and EFA.

**Promissory
note**

Students must complete and sign a promissory note before receiving their first Direct Loan disbursement. For more information on promissory notes, see the *Direct Loan School Guide*.

**Membership
in religious
organizations**

As explained in Chapter 2, students who are members of certain religious organizations are considered to have no financial need for SFA Program purposes and are therefore ineligible for Direct Subsidized Loans; however, these students may be eligible for Direct Unsubsidized Loans. (Note that the parent of such a student is not precluded from borrowing a Direct PLUS Loan for that student.) For further details, see Chapter 2, Section 1.

A student is **ineligible** to receive a Direct Loan while in a medical internship or residency program. Students in **dental** internship programs are **eligible** to receive Direct Loans.

A student who has had a Direct Loan canceled due to total and permanent disability may reestablish eligibility for a new loan by (1) obtaining a statement from a physician certifying that the student can engage in substantial gainful activity and (2) signing a statement acknowledging that the new Direct Loan cannot be canceled because of any impairment present when that loan is made, unless the impairment substantially deteriorates.

Students who are in default on federal student loans, have obtained federal student loan funds in excess of annual or aggregate loan limits, or have received overpayments of SFA funds are not eligible for Direct Loans or any other SFA Program funds. A student in any of these situations can regain eligibility for SFA funds, including Direct Loans, by repaying in full the amount owed or by taking other steps.

- ◇ For purposes of regaining Direct Loan eligibility in cases of default, the borrower must make “satisfactory repayment arrangements,” defined as six consecutive, voluntary, on time, full monthly payments that are reasonable and affordable given the borrower’s financial situation. “On time” means a payment made within 15 days of the scheduled due date. “Voluntary” payments are those the borrower makes directly, regardless of whether a judgment exists. Voluntary payments do not include those obtained by income tax offset, garnishment, or income or asset execution. For the purpose of regaining eligibility, a student may make satisfactory repayment arrangements on a defaulted Direct Loan only once. (See Section 4 for more information on resolving defaults.)
- ◇ Students who have inadvertently exceeded loan limits or received overpayments must make repayment arrangements satisfactory to the holder of the loan or the holder of the overpayment debt. Students who exceed Direct Loan limits must contact their Direct Loan Servicing Center to establish repayment arrangements satisfactory to the Department.

If a student regains eligibility during an enrollment period (for example, if the sixth payment under a satisfactory repayment arrangement is made after the start of an enrollment period), the student regains eligibility for the entire loan period.

***Internships/
residencies***

***Eligibility
after
disability
cancellation***

***Default,
excess
borrowing,
and
overpayment***

***Regaining
eligibility
during
enrollment
period***

Chapter 2, Section 1 discusses in detail overpayment, borrowing in excess of loan limits, and regaining eligibility for SFA Programs. For more information on the consequences of default for borrowers, see page 11-57 of this chapter.

PARENT BORROWER ELIGIBILITY

For purposes of Direct PLUS Loan eligibility, an eligible parent borrower is a student's biological mother or father, adoptive parent, or legal guardian. A parent also includes the spouse of a parent who remarries, if that spouse's income and assets would be taken into account when calculating a dependent student's EFC.

A parent must use the Direct PLUS Loan to pay for the educational expenses of a dependent undergraduate student who meets the requirements for an eligible student (see Chapter 2).

Application/ promissory note

A parent must submit a Direct PLUS Loan application/promissory note to the school or to the Department's Loan Origination Center, depending on the school's origination level. A parent does not have to complete the FAFSA unless the student for whom the parent plans to borrow is applying for other SFA funds—or nonfederal funds—that require the FAFSA. However, note that to make a late disbursement of a Direct PLUS Loan, the school must have a SAR or ISIR for the student with an official EFC. For more information on PLUS application/promissory note procedures, see the *Direct Loan School Guide*.

General eligibility requirements

A parent must meet the same requirements as a student applying for SFA Program funds when it comes to citizenship status, defaults, overpayments, and previous loans canceled due to total and permanent disability. A parent also must comply with the requirements for submitting a Statement of Educational Purpose (see Chapter 2). In addition, the parent must provide his or her Social Security Number and the student's Social Security Number.

A parent is not allowed to borrow a Direct PLUS Loan and a Federal PLUS Loan for the same student for the same enrollment period at the same school.

Adverse credit history

Direct PLUS Loans are not available to a parent with an adverse credit history unless he or she obtains an endorser with no adverse credit history or demonstrates extenuating circumstances. (See Section 2 for more information on credit history requirements.)

ELIGIBILITY AFTER BANKRUPTCY DISCHARGE

To be eligible for SFA Program funds, including Direct Loans, borrowers do not have to reaffirm loan or overpayment obligations discharged in bankruptcy. The Bankruptcy Reform Act of 1994 prohibits denial of aid based solely on a bankruptcy discharge. However, a parent borrower who wishes to receive a Direct PLUS Loan within 5 years following a bankruptcy discharge may be required to obtain an endorser or document extenuating circumstances.

A federal student loan or federal grant overpayment is not dischargeable in bankruptcy unless the debt has been outstanding for at least seven years, excluding any periods of deferment or forbearance, or unless the bankruptcy court has determined that repaying the debt would cause undue hardship to the debtor and his or her dependents.

An applicant for SFA funds who has a defaulted federal student loan (or grant overpayment) determined **nondischargeable** in the bankruptcy filing will be considered ineligible for further federal student aid until the default or overpayment status is resolved as discussed on page 11-7. If a default or overpayment occurred before the borrower's bankruptcy filing and the debt was discharged in bankruptcy, the applicant is eligible for further federal student aid. The applicant does not have to establish satisfactory repayment arrangements because the debt no longer exists.

A borrower who listed a dischargeable SFA debt in a bankruptcy filing is also eligible for further federal student aid before the debt is actually discharged. The borrower must provide documentation to the school from the holder of the debt stating that the debt is dischargeable.

REFUSAL TO ORIGINATE A LOAN

A school may refuse to originate any Direct Loan or may originate an amount less than a borrower's calculated need if the school

- ◇ makes such decisions on a case-by-case basis;
- ◇ does not engage in any pattern or practice that results in denying access to Direct Loans because of a borrower's race, gender, color, religion, national origin, age, disability status, or income;
- ◇ documents the reason for the decision and keeps that documentation in the student's file; and
- ◇ notifies the student or parent in writing of the decision.

INSTITUTIONAL ELIGIBILITY



The Department selects schools to participate in the Direct Loan Program, drawing from colleges, universities, graduate and professional schools, vocational schools, and proprietary schools. To the extent possible, the Department selects schools reasonably representative of those participating in the FFEL Program in terms of anticipated loan volume, length of academic program, type of control, highest degree offered, size of enrollment, geographic location, and default history. At the time this Handbook went to print, the separate *William D. Ford Federal Direct Loan Program Participation Application* had been eliminated. Schools interested in participating should contact the Direct Loan Task Force at (202) 708-9951 for more information.

To participate in the Direct Loan Program, schools must meet the general institutional eligibility definitions and criteria described in Chapter 3. Direct Loan schools also must meet and maintain other requirements, as discussed below.

Correspondence study

A school offering programs **exclusively** for study by correspondence is not eligible to participate in Direct Loans.

Initial participation

To qualify for initial participation in the Direct Loan Program, a school must not be subject to an emergency action or a proposed or final Limitation, Suspension, and Termination action. In addition, a school must meet the eligibility requirements in Section 435(a) of the Higher Education Act, including the requirement that the cohort default rate be less than 25% for at least one of the three most recent fiscal years for which data are available. Note that the cohort default rate requirement is not solely an initial participation requirement. See Section 4 for information on cohort default rate requirements.

Program Participation Agreement

To participate in Direct Loans, a school must sign an addendum to the Department's Program Participation Agreement. The chief executive officer signs the agreement on the school's behalf.

If schools apply as a consortium, each school in the consortium must meet the eligibility requirements described above and must sign a separate Program Participation Agreement.

The signed agreement obligates the school to comply with statutory and regulatory requirements. The agreement allows schools to participate simultaneously in the Direct Loan and FFEL programs; however, as mentioned earlier, individual students may not receive loans under both programs for the same enrollment period at the same school.

The agreement requires schools to identify eligible students, estimate their financial need, and certify that borrowers have not exceeded annual or aggregate loan limits. Schools also must provide timely and accurate information to help the Department service the loans and collect repayments. Such information includes the status of student borrowers—and the status of students for whom parents have borrowed—while these students are still enrolled. In addition, at the Department’s request, a school must provide any new information about borrowers obtained after the students leave school.

Other provisions in the agreement require schools to

- ◇ refrain from charging fees of any kind for origination activities or for providing Direct Loan information to student or parent borrowers,
- ◇ implement a quality assurance system, and
- ◇ comply with other provisions the Department determines necessary to protect the interests of the United States and to promote the Direct Loan Program’s purposes.

Option 1 or 2 schools or consortia must meet additional criteria:

- ◇ have participated in the Federal Perkins Loan Program or the Federal Pell Grant Program or, for a graduate or professional school, have participated in a similar program for the three most recent years;
- ◇ not be on the reimbursement system of payment in the Federal Pell Grant Program;
- ◇ have had no severe performance, audit, or program review deficiencies for any SFA Program;
- ◇ be financially responsible in accordance with the standards of 34 CFR 668.15;
- ◇ be current on program and financial reports and SFA audits for the 12-month period immediately preceding the Direct Loan application date;
- ◇ be current on required federal cash transaction reports and have no final determination of cash on hand that exceeds “immediate need”;

***Requirements
for Option 1
and Option 2
schools/
consortia***

- ◇ have no material findings in annual financial audits submitted for the three most recent years preceding the date of application to participate in Direct Loans; and
- ◇ provide assurance that the school has no delinquent debts to the federal government, unless the debts are being repaid under an arrangement satisfactory to the government or unless the Department decides the appropriate federal agency has not determined the existence or amount of the debts.

Participation for deferment purposes only

A school that has never participated in SFA Programs but wants to be considered an eligible school **for deferment purposes only** must prove, before it can certify deferment forms, that it meets the Department's definition of an eligible school. For more information about eligibility for deferment purposes, schools should write

U.S. Department of Education
Room 3915, Initial Participation Branch
600 Independence Avenue SW
Washington, DC 20202-5244

WITHDRAWING FROM THE DIRECT LOAN PROGRAM

A school may withdraw from the Direct Loan Program by notifying the Department in writing at least 60 days before the planned withdrawal date. Unless the Department approves an earlier date, the withdrawal is effective (1) 60 days after the school notifies the Department or (2) the date the school designates, whichever is **later**.

Whether program withdrawal is voluntary or the result of Department action, an SFA audit is required as is a final reconciliation to account for all funds drawn down.

Loss of eligibility

For steps a school must take if it loses its eligibility to participate in Direct Loans, see Chapter 3. For loss of eligibility due to high cohort default rates, see page 11-65.

section 2

Direct Subsidized Loans, Direct Unsubsidized Loans, and Direct PLUS Loans

This section compares the terms and conditions of Direct Subsidized Loans, Direct Unsubsidized Loans, and Direct PLUS Loans.

CREDIT HISTORY

A borrower's credit history does not affect his or her eligibility to borrow Direct Subsidized and Unsubsidized Loans. For Direct PLUS Loans, credit history is a factor: A parent with an adverse credit history is not eligible for a Direct PLUS Loan unless the parent meets additional criteria, discussed below.

The Loan Origination Center obtains a credit report for every Direct PLUS Loan applicant. An applicant is considered to have an adverse credit history if he or she

- ◇ is delinquent in repaying any debt by 90 days or more as of the date of the credit report;
- ◇ has, during the five years preceding the credit report's date, been determined to be in default on a debt; has had his or her debts discharged in bankruptcy; or has been the subject of foreclosure, repossession, tax lien, wage garnishment, or write-off of an SFA debt.

The absence of a credit history is not considered to be an adverse credit history. That is, a parent cannot be rejected for a Direct PLUS Loan because he or she has no credit history.

A parent may still be able to receive a Direct PLUS Loan by obtaining an endorser with no adverse credit history. (The endorser may not be the student for whom the parent is borrowing.) Alternatively, a parent may appeal a determination of adverse credit history to the Department by documenting extenuating circumstances. If the Department is satisfied such circumstances exist, the parent is allowed to borrow a Direct PLUS Loan.

**34 CFR
685.200(b)(1)(vii)**

**Endorser and
extenuating
circumstances**

LOAN LIMITS

Direct PLUS Loans

Direct PLUS Loans do not have finite annual and aggregate loan limits, as do Direct Subsidized and Unsubsidized Loans (see below). A parent may borrow any amount up to the dependent student’s cost of attendance (COA) minus other estimated financial assistance for that student (COA - EFA = Direct PLUS Loan limit).

Direct Subsidized and Unsubsidized Loans

Loan limits for Direct Subsidized and Unsubsidized Loans and subsidized and unsubsidized Federal Stafford Loans are the same. The chart below shows the maximum amounts a student may borrow in a combination of Direct Subsidized and Unsubsidized Loans. Direct Loan Program borrowing limits always include the amounts a student has outstanding in subsidized and unsubsidized loans **under both the Direct Loan and FFEL programs**, even if the student has consolidated any of these loans. If the borrowing limits have been met, the loans must be repaid in full or in part before a student may apply again for Direct Subsidized or Unsubsidized Loans. Federal and Direct PLUS Loans are not included when assessing outstanding subsidized and unsubsidized indebtedness.

Direct Subsidized and Unsubsidized Combined Annual and Aggregate Loan Limits

Student Year	Annual Limit	Aggregate Limit
Dependent Undergraduates		
1st year	\$2,625	
2nd year	\$3,500	
3rd, 4th, and 5th years	\$5,500	\$23,000
Independent Undergraduates		
1st year	\$6,625 ¹	
2nd year	\$7,500 ²	
3rd, 4th, and 5th years	\$10,500 ³	\$46,000 ⁴
Graduate Students	\$18,500 ⁵	\$138,500 ⁶

1. No more than \$2,625 of this amount may be in subsidized loans.
2. No more than \$3,500 of this amount may be in subsidized loans.
3. No more than \$5,500 of this amount may be in subsidized loans.
4. No more than \$23,000 of this amount may be in subsidized loans.
5. No more than \$8,500 of this amount may be in subsidized loans.
6. No more than \$65,500 of this amount may be in subsidized loans.

Direct Loan Program: Undergraduate Annual Loan Limits

Student Year	Length of Program or Final Period of Study			
	Full academic year	2/3 to less than full academic year	1/3 to less than 2/3 academic year	Less than 1/3 academic year
1st year				
Dependent and Independent Students Subsidized and Unsubsidized	\$2,625	\$1,750	\$875	0
Independent Student Unsubsidized	\$4,000	\$2,500	\$1,500	0
2nd year				
Dependent and Independent Students Subsidized and Unsubsidized	\$3,500	Proportional Proration	Proportional Proration	Proportional Proration
Independent Student Unsubsidized	\$4,000	\$2,500	\$1,500	0
3rd year or higher				
Dependent and Independent Students Subsidized and Unsubsidized	\$5,500	Proportional Proration	Proportional Proration	Proportional Proration
Independent Student Unsubsidized	\$5,000	Proportional Proration	Proportional Proration	Proportional Proration

A dependent undergraduate student who has not yet successfully completed his or her first year of study may borrow combined subsidized and unsubsidized loans not to exceed an annual total of

- ◇ \$2,625 for a program of study at least an academic year in length;
- ◇ \$1,750 for a program of study at least two-thirds of an academic year but less than a full academic year in length; and
- ◇ \$875 for a program of study at least one-third but less than two-thirds of an academic year in length.

Dependent undergraduate students

Note: Students may not receive Direct Loans for programs that are less than one-third of an academic year.

A dependent undergraduate student who has successfully completed his or her first year of study but not the second year may borrow up to \$3,500 in combined subsidized and unsubsidized loans for a period of at least an academic year in length. If the remaining portion of the program is less than an academic year, the loan must be prorated. (See page 11-19 for a discussion of proration.)

For a dependent undergraduate student who has successfully completed his or her first and second year of study but not the remainder of the program, the combined subsidized and unsubsidized loan limit is \$5,500 for a period of at least an academic year in length. If the remaining portion of the program is less than an academic year, the loan must be prorated.

The maximum aggregate amount dependent undergraduates may borrow in a combination of subsidized and unsubsidized loans is \$23,000.

Independent students are eligible for higher annual and aggregate limits in Direct Unsubsidized Loans, as the charts on the previous pages show.

Independent undergraduate students

An independent undergraduate student who has not yet successfully completed his or her first and second year of study may borrow additional amounts of Direct Unsubsidized Loans not to exceed

- ◇ \$4,000 for a program of study (or remaining portion of a program) that is at least an academic year in length;
- ◇ \$2,500 for a program of study (or remaining portion of a program) that is at least two-thirds but less than a full academic year in length; and
- ◇ \$1,500 for a program of study (or remaining portion of a program) that is at least one-third but less than two-thirds of an academic year in length.

As mentioned earlier, students may not receive Direct Loans for programs that are less than one-third of an academic year.

An independent undergraduate student who has successfully completed his or her first and second year of study but not the remainder of the program may borrow additional amounts of Direct Unsubsidized Loans not to exceed \$5,000 for a period of at least an academic year in length. If the remaining portion of the program is less than an academic year, the loan must be prorated (see page 11-19).

The maximum aggregate amount an independent undergraduate may borrow in Direct Subsidized and Unsubsidized Loans is \$46,000. However, no more than \$23,000 of this amount may be in subsidized loans. Remember that the aggregate limit includes amounts borrowed under the FFEL Program.

Dependent students may be eligible for the same annual and aggregate loan limits as independent undergraduate students if it is likely a parent will be precluded from borrowing Direct PLUS Loans and is otherwise unable to provide the EFC. The school must receive documentation of exceptional circumstances showing why a parent cannot borrow. Such circumstances include an adverse credit history or situations where the parent's whereabouts are unknown, the parent is incarcerated, or the parent receives only public assistance or disability benefits.

Financial aid administrators must review the family's financial status and consider their students' indebtedness before permitting them to borrow under higher Direct Unsubsidized Loan limits. Aid administrators also must put in writing the reason the parent cannot obtain a Direct PLUS Loan and keep supporting documentation in the student's file.

Graduate students may borrow up to \$18,500 annually in a combination of subsidized and unsubsidized loans. No more than \$8,500 may be in subsidized loans. Loans for graduate students are not subject to proration. The maximum aggregate amount, which includes both undergraduate and graduate borrowing, is \$138,500. No more than \$65,500 of this amount may be in subsidized loans.

Annual Direct Loan limits are restricted by the time period to which they apply. That is, to be eligible to receive a subsequent loan, a borrower must meet certain calendar time or academic progress standards. For more information, see "Frequency for Annual Loan Limits" in this section.

A student's academic year level for loan limit purposes is set according to the school's standards for the time normally required to complete a given program. For example, if the school determines a program normally can be completed in two years of full-time study, a student in that program can never receive more than the second-year annual loan limit of \$3,500 in any given year, no matter how long it takes the student to finish. Further, in a program of undergraduate study, the number of years a student has completed includes any prior enrollment in an eligible program of undergraduate education for which the student was awarded an associate or bachelor's degree—if the school requires the degree for admission to the program in which the student is currently enrolled at the school.

***Dependent student eligibility for higher limits—
34 CFR 685.203(c)***

Graduate students

Frequency for annual loan limits

Determining academic year level

Teacher certification

There are two cases (teacher certification and preparatory coursework) where students are eligible for Direct Loans without being enrolled in an eligible program (see Chapter 2, Section 1). Loan limits for these students are affected by factors besides the length of the program. Students enrolled in teacher certification or recertification programs are considered as fifth-year undergraduate students when determining annual loan limits and may borrow up to \$5,500 a year (plus \$5,000 in unsubsidized loans for an independent student), subject to reductions for programs less than an academic year in length.

Preparatory coursework

Students taking coursework necessary for enrollment in an eligible program for a single period of up to 12 consecutive months may receive Direct Loans for this preparatory coursework. Students preparing for an undergraduate program borrow at the loan level determined for first-year undergraduates. A student with a bachelor's degree preparing for a graduate or professional program may borrow up to the annual loan limit for fifth-year undergraduates.

Exceeding loan limits

Students who borrow more than the annual or aggregate loan limits for which they are eligible under SFA loan programs will lose eligibility for further aid from **any** SFA Program until the excess amount is repaid in full or unless other arrangements are made (see Section 1).

**Health profession students' eligibility for higher unsubsidized limits—
P.L. 104-134**

An increase in **annual** Direct Unsubsidized Loan limits is permitted for students who could have borrowed under the Health Education Assistance Loan (HEAL) Program but who are no longer eligible because they did not borrow under that program before October 1, 1995. Students in this category who are enrolled **full time** in schools participating in the HEAL Program are eligible for higher Direct Unsubsidized Loan amounts. Conversely, students who remain eligible to borrow under HEAL (students who **did** receive HEALs before October 1, 1995) may **not** receive increased Direct Loan amounts.

A school participating in HEAL is one that made HEAL disbursements during Fiscal Year 1995 (October 1, 1994 through September 30, 1995) and has continued to participate in the program. Schools that have withdrawn from the HEAL program—or have simply stopped making HEALs—after FY 95 may originate Direct Loans at the increased limits for any loan period beginning before July 1, 1998 (see “Dear Colleague” Letter GEN-97-4 for more information). The Department will notify such schools if they are permitted to originate at the increased limit after July 1, 1998.

When determining additional Direct Unsubsidized Loan limits, participating HEAL schools must use the current HEAL Program and Discipline loan limits, described in the Department of Health and Human Services “Student Financial Aid Guidelines Notebook” in Section 104.3.2. Note that, unlike in HEAL, no need analysis is required for the extra Direct Unsubsidized Loan amounts.

In general, **aggregate** Direct Unsubsidized Loan limits still apply for health professions students. The Department is increasing the aggregate limit only for those health professions students who are eligible to receive the increased annual amounts. The new aggregate limit for these students (and only these students) will be \$189,125, less the aggregate amounts of any subsidized loans made to the student. The Department plans to publish a “Dear Colleague” Letter on this topic shortly. When issued, this up-to-date information will also be available on the SFA BBS.



PRORATED ANNUAL LOAN LIMITS—DIRECT SUBSIDIZED AND UNSUBSIDIZED LOANS

Generally, a dependent or independent undergraduate may borrow up to the annual limit applicable to the student’s year in school. However, the maximum amount an undergraduate student may borrow must be reduced, or **prorated**, in certain situations. **Note that Direct PLUS Loans are not subject to proration.**

Proration applies only to undergraduates

Loans must be prorated when a student is enrolled

- ◇ in a program containing fewer weeks, clock hours, or credit hours than the statutory minimum academic year; or
- ◇ in a program that is longer than an academic year, but the final period of study is shorter than an academic year.¹

There are two types of proration: **fixed** and **proportional**.

- ◇ **Fixed** prorated loan limits are set dollar amounts based on the length of a student’s program (or final period of study) in relation to a full academic year.
- ◇ **Proportional** prorated loan limits are calculated amounts based on the ratio of the credit or clock hours in a final period of study to the credit or clock hours in the school’s academic year.

Schools use fixed proration when students are enrolled in programs containing fewer weeks, clock hours, or credit hours than the statutory minimum academic year. Chapter 3 contains extensive information about academic year requirements. Briefly, an academic year must contain at

Program less than AY—fixed proration

¹Proration is also required in certain cases where a program is exactly one academic year long: For example, a student withdraws from a one-year program and later, in a new academic year, completes the program (either re-enrolling at the original school or enrolling at another school). In this case, the student is enrolled in a final period of study that is shorter than an academic year.

least 30 weeks of instructional time² **and** 24 semester or trimester hours, 36 quarter hours, or 900 clock hours. To determine the length of a student’s program in relation to a full academic year, schools must compare two fractions: the number of clock or credit hours in the program divided by the number of hours in the academic year, and the number of weeks of instructional time in the program divided by the number of weeks in the academic year. The lesser of these fractions determines the relation of program length to academic year length.

Fixed proration example

Hector, an independent student, has enrolled in a 650-clock hour, 28-week program. The school defines the academic year for the program as 900 clock hours and 30 weeks of instructional time. Because Hector’s program is shorter than an academic year, his Direct Loans must be prorated. The school compares the two fractions:

$\frac{650 \text{ clock hours in program}}{900 \text{ clock hours in academic year}}$	$\frac{28 \text{ weeks instructional time in program}}{30 \text{ weeks instructional time in academic year}}$
$650/900=.72$	$28/30=.93$

Of the two fractions, the smaller is 650/900 (.72); the school uses .72 as the length of Hector’s program when determining the prorated loan amount. The program is less than a full year but greater than 2/3 (.66) of an academic year. Therefore, Hector may borrow up to \$1,750 in combined Direct Subsidized and Unsubsidized Loans (see the loan limits chart on page 11-15). Because he is an independent student, he may be eligible for an additional prorated Direct Unsubsidized Loan of up to \$2,500.

Final period of study less than AY

Schools must prorate a student’s loan if the final period of study is shorter than an academic year. A final period of study is one at the end of which a student will complete a program. At a **term-based credit hour** school (where the academic year is measured in semesters, trimesters, quarters, or other terms), a final period of study is considered shorter than an academic year if the final period consists of fewer terms than the school’s scheduled academic year. At a **term-based clock hour** school (where the academic year is measured in semesters, trimesters, quarters, or other terms), a final period of study is considered shorter than an academic year if the final period consists of fewer terms than the school’s scheduled academic year **or** fewer clock hours than the minimum statutory requirements for a full academic year. Terms within the same academic year as the student’s final term are considered part of the final period of study, even if separated from the final term by a term in which the student is not enrolled.

²The Department may waive this requirement for some programs of fewer than 30 weeks (see Chapter 3).

Rousimoff College has an academic year that consists of three quarters: fall, winter, and spring. Andre will be enrolling in the fall and spring quarters, but not the winter quarter, and will graduate at the end of the spring quarter. Because the fall quarter is in the same academic year as Andre's final quarter, it is part of the final period of study, even though there is a term between the final quarter and the fall quarter in which Andre will not enroll. Because the fall quarter is part of the final period of study, the loan Andre receives in the fall must be prorated, just as his spring loan must be prorated.

At a **nonterm** school (where programs are measured only in clock or credit hours), a final period of study is considered less than an academic year if the final period consists of fewer clock or credit hours than the minimum statutory requirements for a full academic year.

To prorate the loan for a program that exceeds an academic year but has a final period of study less than a full academic year in length, schools must calculate what proportion of a full academic year the final period of study represents. The loan amount is then prorated on that basis.

Final period example

José is an independent third-year student at Van Dam College. Van Dam's academic year has 36 quarter hours and three quarters. José needs to complete only 24 quarter hours to finish his program and enrolls in the fall and winter quarters. Because his final period of study (2 quarters) is less than an academic year (3 quarters), his Direct Loans must be prorated. The school determines the proportion of the academic year the final period of study represents by dividing the credit hours in this period by the number in a full academic year:

$$\frac{24 \text{ quarter hours in final period}}{36 \text{ quarter hours in academic year}}$$

The school then multiplies the loan limit for all third-year students (\$5,500) by 24/36 to determine the maximum Direct Subsidized Loan José can receive:

$$24/36 \times \$5,500 = \$3,667$$

José can receive up to \$3,667 in combined Direct Subsidized and Unsubsidized Loans. Because José is an independent student, he may be eligible for an additional Direct Unsubsidized Loan. To determine the amount, Van Dam multiplies the Unsubsidized limit for independent students (\$5,000) by 24/36:

$$24/36 \times \$5,000 = \$3,333$$

José may be eligible for an additional prorated Direct Unsubsidized Loan of up to \$3,333.

In some cases, the school will use both fixed and proportional proration to determine the loan amount for a final period of study. See the example on the next page.

Mixed proration example

Andre is an independent second-year student at Rousimoff College. He has 16 quarter hours to complete in his program and will enroll in the fall and spring quarters. Each quarter at Rousimoff consists of 10 weeks of instructional time. Andre will graduate at the end of the spring quarter. Because this final period of study is shorter than an academic year, Andre's Direct Loans must be prorated. Rousimoff determines the length of the final period by dividing the number of quarter hours in the period by the number of hours in the academic year:

$$\frac{16 \text{ quarter hours in final period}}{36 \text{ quarter hours in academic year}}$$

The school then multiplies the loan limit for all second-year students (\$3,500) by 16/36 to determine the maximum amount Andre can receive in combined Direct Subsidized and Unsubsidized Loans:

$$16/36 \times \$3,500 = \$1,556$$

Because Andre is an independent student, he may be eligible for an additional Direct Unsubsidized Loan. The school compares the two fractions required for fixed proration:

$\frac{16 \text{ quarter hours in final period}}{36 \text{ quarter hours in academic year}}$	$\frac{20 \text{ weeks instructional time in final period}}{30 \text{ weeks instructional time in academic year}}$
$16/36 = .44$	$20/30 = .67$

Of the two fractions, the smaller is .44; the school uses .44 as the length of Andre's final period of study when determining the prorated loan amount. The period is less than 2/3 of an academic year (.66) but greater than 1/3 (.33). Therefore, Andre may be eligible for an additional prorated Direct Unsubsidized Loan of up to \$1,500.

Enrollment status changes

If a student drops or adds a course after the school has originated a prorated loan, the school **may** readjust the loan amount but is not required to do so. Of course, a student who drops courses must still be enrolled at least half time to be eligible for any loan amount.

FREQUENCY OF ANNUAL LOAN LIMITS

The annual loan limit for Direct Loans limits how much a student can borrow in a single academic year. Once the student has reached the annual loan limit, he or she cannot receive another Direct Loan until he or she begins another academic year. There are two types of academic year a school can use in determining when another year will begin for the student: a scheduled academic year (SAY) or a borrower-based academic year (BBAY). Only term-based credit-hour programs can use SAYs. Clock-hour and nonterm credit-hour programs must use BBAYs. If a program at

a term-based credit-hour school contains fewer than 30 weeks of instructional time in a year (unless the Department grants a waiver for an academic year of less than 30 weeks), the school must use only SAYs for borrowers in that program.

Scheduled Academic Year

An SAY is a fixed period of time that generally begins and ends at the same time each calendar year (for example, beginning on the first day of the fall semester and ending on the last day of the spring semester). The SAY generally corresponds to the academic year or calendar that is published in the school's catalog or other materials. An SAY must meet the statutory requirements of an academic year, as described in Chapter 3.

For a program that uses SAYs, a summer term may be part of the academic year that preceded that term (that is, it may be a "trailer"), or it may be part of the academic year that follows that term (that is, it may be a "leader"). The school can

- ◇ use a strict policy that summer terms are always either trailers or leaders,
- ◇ determine whether a summer term is a trailer or leader on a program-by-program basis, or
- ◇ determine whether a summer term is a trailer or leader on a case-by-case basis.

Summer mini-sessions can be grouped together as a single trailer or leader, or they can be treated separately and assigned to different SAYs. If the summer mini-sessions are grouped and treated as a single term, the summer cost of attendance cannot include costs for a mini-session for which the student was not enrolled.

Borrower-Based Academic Year

A BBAY is not a set period like an SAY; instead, the BBAY's beginning and end dates depend on an individual student's enrollment and progress. For example, a school that has new students beginning enrollment every month might use a BBAY for each student that begins in the month the student enrolls, rather than using an SAY that begins in the fall regardless of when the student actually begins classes. Like an SAY, the BBAY must meet the minimum statutory requirements for an academic year (see the next page for one exception to this requirement for term-based credit-hour programs).

Summer terms

As noted previously, a school must use BBAYs for clock-hour and nonterm credit-hour programs. A school may choose to use a BBAY instead of an SAY for a term-based credit-hour program unless the program contains fewer than 30 weeks of instructional time in a year; in this case, as mentioned earlier, the school must use an SAY for the program.

Term-based credit-hour programs

For a term-based credit-hour program, the school can use BBAYs for all its students or just for students enrolled in certain programs, or it may use BBAYs on a student-by-student basis. The school can also alternate BBAYs with SAYs for a student, but the academic years must not overlap. A school that has these choices for academic year standards must have a written policy that explains how it applies these options when calculating loan eligibility.

The BBAY must include the same number of terms as the SAY the school would otherwise use (not including any summer trailer or leader). The BBAY may include terms and /or mini-sessions the student does not attend if the student could have enrolled at least half time in those terms or mini-sessions; however, unlike an SAY, the BBAY must begin with a term in which the student actually enrolled. Also, any mini-sessions (summer or otherwise) that run consecutively **must** be combined and treated as a single term. If the BBAY includes a summer term, the BBAY need not meet the 30-week minimum requirement for an academic year.

Clock-hour programs, nonterm programs

For a clock-hour or nonterm program, the BBAY begins when the student enrolls. Because a BBAY must meet the minimum statutory requirements for an academic year, the BBAY must contain at least 30 weeks of instructional time and the appropriate number of credit or clock hours (24 semester or trimester hours, 36 quarter hours, or 900 clock hours). The BBAY does not end until the student has completed the number of weeks **and** the number of hours in the academic year. A student who is attending less-than-full time will take longer to complete the academic year than a full-time student.

Eligibility for Further Loans

In general, once the student has reached the annual loan limit, he or she cannot receive another Direct Loan until he or she begins a new academic year. A student who has already received one Direct Loan within an academic year may receive another loan if he or she has not yet reached the annual limit. In addition, a student who has already borrowed up to the annual limit within an academic year can receive another loan if his or her annual limit is increased, either because he or she progresses to a grade level with a higher limit or because his or her dependency status changes to independent. In all cases, the student may borrow the

difference between the amount already borrowed within the academic year and the student's loan limit.

Note that for a nonterm program, the student will never progress to a higher grade level within an academic year, and thus will only have a change in the loan limit if his or her dependency status changes. The student only moves to a higher grade level when he or she completes the BBAY.

INTEREST RATES

The interest rates for Direct Subsidized and Unsubsidized Loans are the same, but the Department does not charge interest to Direct Subsidized Loan borrowers during the in-school, grace, and deferment periods. Direct Unsubsidized Loan borrowers are responsible for interest during all periods, including in-school, grace, and deferment periods.

The Department also does not subsidize Direct PLUS Loans; borrowers are responsible for all interest, including that which accrues during the student's in-school period and during periods of deferment for the parent.

All borrowers are charged interest during forbearance periods.

Interest rates are variable; legislation caps them at 8.25% for Direct Subsidized and Unsubsidized Loans and at 9% for Direct PLUS Loans. Interest rates are determined on June 1 each year and apply to the following 12-month period from July 1 to June 30.

Currently, there are two formulas for calculating the variable interest rate for Direct Subsidized and Unsubsidized Loans:

- ◇ For loans first disbursed between July 1, 1995 and June 30, 1998 that are in **in-school, grace, or deferment periods**, the interest rate equals the bond equivalent rate of the 91-day Treasury bills auctioned at the final auction before June 1, plus **2.5** percentage points. The rate for these loans for July 1, 1997 through June 30, 1998 is 7.66%.
- ◇ For loans first disbursed between July 1, 1995 and June 30, 1998 that are **not in in-school, grace, or deferment periods**, the interest rate equals the bond equivalent rate of the 91-day Treasury bills auctioned at the final auction before June 1, plus **3.1** percentage points. The rate for these loans for July 1, 1997 through June 30, 1998 is 8.25%. **Note** that this formula is also used for *any* Direct Subsidized or Unsubsidized Loan first disbursed before July 1, 1995, in *any* period.

***Subsidized
and
Unsubsidized
Loans: two
interest
formulas***

Direct PLUS

Currently, the interest rate for Direct PLUS Loans equals the bond equivalent rate of the 52-week Treasury bills auctioned at the final auction before June 1, plus 3.1 percentage points. The rate for these loans for July 1, 1997 through June 30, 1998 is 8.98%.

Future change in interest rate calculations

Beginning July 1, 1998, interest rate calculations change. For Direct Subsidized and Unsubsidized Loans first disbursed on or after July 1, 1998, the interest rate will equal the bond equivalent rate of the security with a comparable maturity, that the Department will establish, plus 1 percentage point. The rate will still be determined on June 1 each year and apply to the following 12-month period from July 1 to June 30. The rate will not exceed 8.25%. **This interest rate calculation applies whether or not a loan is in an in-school, grace, or deferment period.** The same calculation applies to Direct PLUS Loans first disbursed on or after July 1, 1998, except the rate will equal the bond equivalent rate of the security with a comparable maturity, that the Department will establish, plus 2.1 percentage points. The rate will not exceed 9%. Specific information on which securities' bond equivalent rates will be used was not available at the time this Handbook went to print. The Department will issue further guidance on this topic at a later date, in the form of a "Dear Colleague" Letter. When issued, this up-to-date information will also be available on the SFA BBS.

During certain periods, borrowers may choose to pay the interest for which they are responsible:

- ◇ Direct Subsidized Loan borrowers may choose to pay interest as it accrues during forbearance.
- ◇ Direct Unsubsidized Loan borrowers may choose to pay interest as it accrues during in-school, grace, deferment, and forbearance periods.
- ◇ Direct PLUS Loan borrowers may choose to pay interest as it accrues during deferments or forbearance.

Capitalizing interest

If borrowers choose not to make interest payments during applicable periods, the interest is capitalized, that is, added to the borrower's loan principal.

- ◇ Interest that accrues and is not paid on a Direct Subsidized loan during forbearance is capitalized when that period ends.
- ◇ Interest that accrues and is not paid on a Direct Unsubsidized Loan before the loan enters repayment is capitalized when the loan enters repayment.

- ◇ Interest that accrues and is not paid on a Direct Unsubsidized Loan or Direct PLUS Loan during a period of deferment or forbearance is capitalized when that period ends.

Accrued interest is capitalized annually for Direct Subsidized and Unsubsidized Loans repaid under the Income Contingent Repayment (ICR) Plan (or under an alternative repayment plan) when the borrower's payments are not high enough to cover the interest amounts that accrue. The amount of interest that may be capitalized in such cases is limited. (See page 11-28 for more information on repayment plans and 11-32 for more information on ICR capitalization.)

The Department may capitalize unpaid interest on any Direct Loan that defaults.

Capitalizing interest increases the loan's principal balance, the interest that must be paid during repayment, and the total amount the borrower will pay over the life of the loan.

ADDITIONAL BORROWING COSTS

The Department charges a loan fee of 4% of the principal for any Direct Loan (except a Direct Consolidation Loan) and deducts this fee from the loan proceeds. A prorated portion of the fee is deducted from each disbursement. If the loan is canceled or the loan amount is adjusted downward within 120 days of disbursement, the Department cancels or reduces the loan fee attributable to the disbursement portion repaid. A school that learns it should have canceled, but did not cancel, a borrower's loan proceeds within 120 days of disbursement should identify all affected loan records and report the date the loan(s) should have been canceled. This action will ensure that borrowers will not be charged loan fees for which they should not be responsible.

Loan fees

The Department can require borrowers to pay a late charge of up to six cents for each dollar of a required monthly payment (or portion of a payment) not paid within 30 days after the due date. **Currently, the Department is not charging late fees.**

Late charge

On a Direct Loan **not** in default, the Department may require borrowers or endorsers to pay any costs, in excess of routine collection costs, incurred in collecting installments not paid when due. Such charges do not include routine costs of preparing letters or notices or making local or long-distance telephone calls. An example of a non-routine collection cost is the cost of processing checks returned for insufficient funds. On a Direct Loan in default, the Department requires borrowers and any endorsers to pay additional costs.

Collection charges

GRACE PERIODS—DIRECT SUBSIDIZED AND UNSUBSIDIZED LOANS

A six-month grace period begins the day after a Direct Subsidized or Unsubsidized Loan borrower ceases to be enrolled as at least a half-time student at an eligible school. During the grace period, Direct Subsidized Loan borrowers are not required to make payments on loan principal and are not charged interest. Direct Unsubsidized Loan borrowers are not required to make payments on loan principal but are responsible for the interest that accrues.

A borrower who returns to school as at least a half-time student before the grace period ends may again postpone loan repayment while in school and will be entitled to a full grace period after terminating enrollment or dropping below half-time status. Once a borrower's grace period expires, he or she must request, and be granted, a deferment or forbearance in order to postpone payments on a Direct Subsidized or Unsubsidized Loan. (See "Deferment" on page 11-34 and "Forbearance" on page 11-37.)

The grace period for a Direct Subsidized or Unsubsidized Loan borrower enrolled in a correspondence program begins on the earliest of the date

- ◇ the borrower completes the program,
- ◇ the borrower falls 60 days behind the due date for submitting a scheduled assignment,³ or
- ◇ that is 60 days following the latest allowable date the school establishes for completing the program.

A Direct PLUS Loan borrower does not receive a grace period.

REPAYMENT

Direct Subsidized and Direct Unsubsidized Loans

The loan repayment period for Direct Subsidized Loans and Direct Unsubsidized Loans begins the day after the grace period ends. At that point, all borrowers become responsible for paying the principal and interest. The first payment is due within 60 days of the start of the repayment period.

³Schools have the authority to allow one restoration of in-school status for borrowers who are 60 days late submitting a correspondence assignment. The borrower is required to state in writing, within the 60-day period, that he or she intends to continue in the program. The written statement also must show the borrower understands that required lessons must be submitted on time.

The repayment period for Direct PLUS Loans begins the day the loan is **fully** disbursed. The first payment of principal and interest is due within 60 days after the final loan disbursement.

All loan payments are applied in this order: (1) accrued charges and collection costs, (2) outstanding interest, and (3) outstanding principal.

Direct Subsidized and Unsubsidized Loan borrowers may repay their loans through one of the following repayment plans:

- ◇ the Standard Repayment Plan,
- ◇ the Extended Repayment Plan,
- ◇ the Graduated Repayment Plan,
- ◇ the Income Contingent Repayment Plan, or
- ◇ an alternative repayment plan

Direct PLUS Loan borrowers may choose from any of these plans except Income Contingent Repayment.

In general, all of a borrower's Direct Loans must be repaid under the same repayment plan, except that a borrower may repay a Direct PLUS Loan or Direct PLUS Consolidation Loan separately from other Direct Loans. The *Repayment Book* explains repayment plans in detail.

Shortly before a loan enters repayment, the borrower receives information from the Department's Direct Loan Servicing Center about the various repayment plans (including the estimated amounts the borrower would pay under each plan) and a request that the borrower select a plan. Borrowers who fail to choose are automatically placed in the Standard Repayment Plan.

The time a borrower's loan is in repayment will vary depending on the total amount owed and the repayment plan selected.

Direct PLUS Loans

Repayment plans

Direct Loan Program Repayment Plans¹

<p>Standard Repayment Plan</p>	<ul style="list-style-type: none"> • Fixed annual repayment amount paid over a fixed period of time² • Maximum repayment period 10 years³ • \$50 minimum monthly payment
<p>Extended Repayment Plan</p>	<ul style="list-style-type: none"> • Fixed annual repayment amount paid over an extended period of time² • Maximum repayment period varies depending on total amount of borrower's Direct Loans^{3,4} • \$50 minimum monthly payment
<p>Graduated Repayment Plan</p>	<ul style="list-style-type: none"> • Two or more graduated levels of repayment² • Maximum repayment period varies depending on total amount of borrower's Direct Loans^{3,4} • Minimum monthly payments may not be less than 50%, nor more than 150%, of the payment if loan were repaid under the Standard Repayment Plan • Minimum monthly payment must at least cover interest that accrues monthly
<p>Income Contingent Repayment Plan</p>	<ul style="list-style-type: none"> • Not available for Direct PLUS Loans or Direct PLUS Consolidation Loans • Maximum repayment period may not exceed 25 years^{5,6} • Varying annual payment amounts generally based on AGI of borrower (and spouse) and total amount of Direct Loans but will never exceed 20% of discretionary income

¹ This chart does not include the alternative repayment plan, which will vary from borrower to borrower.

² The monthly amount a borrower pays will reflect changes in the variable interest rate, unless the borrower requests that the maximum number of monthly payments be extended.

³ Excludes any period of authorized deferment or forbearance.

- ⁴
- 12-year maximum repayment period if total amount of Direct Loans is less than \$10,000
 - 15-year maximum repayment period if total amount of Direct Loans is between \$10,000 and \$19,999.99
 - 20-year maximum repayment period if total amount of Direct Loans is between \$20,000 and \$39,999.99
 - 25-year maximum repayment period if total amount of Direct Loans is between \$40,000 and \$59,999.99
 - 30-year maximum repayment period if total amount of Direct Loans is equal to or greater than \$60,000

⁵ If the loan is not repaid within the maximum repayment period, the remaining portion of the loan is canceled. Any canceled loan amount is currently considered taxable income.

⁶ Excludes any periods of authorized deferments or forbearance. Also, if a borrower has made payments under the Standard Plan or the 12-year Extended Plan and then switches to ICR, the earlier payment periods are counted toward the 25-year repayment period. Earlier payment periods in other plans do not count toward the 25-year period.

Standard Repayment

With Standard Repayment, borrowers make fixed payments of at least \$50 a month for up to 10 years. The Standard Repayment Plan may result in the lowest amount of interest paid because the repayment period is shorter than it would be under the other plans. In general, the shorter the repayment period, the lower the total interest a borrower pays over the life of the loan.

With Extended Repayment, borrowers make fixed payments of at least \$50 a month over a period ranging from generally 12 to 30 years, depending on the total amount borrowed.

Extended Repayment

Extended/Graduated Repayment	
Amount of Debt	Repayment Period May Not Exceed
Less than \$10,000	Generally 12 years
\$10,000-\$19,999	15 years
\$20,000-\$39,999	20 years
\$40,000-\$59,999	25 years
\$60,000 or more	30 years

For lower loan amounts, the repayment period may be less than 12 years because a borrower must make payments of at least \$50 a month.

With Graduated Repayment, borrowers' payments start out low, then increase every two years. The repayment period will vary from

Graduated Repayment

generally 12 to 30 years, depending on the total amount borrowed. Under Graduated Repayment, the minimum monthly payment is either the interest that accumulates between payments or one-half the payment a borrower would make using the Standard Repayment Plan, whichever is larger. However, a borrower's monthly payment will never increase to more than one-and-one-half times what the borrower would pay under Standard Repayment. Generally, the amount a borrower repays over the life of the loan will be higher under Graduated Repayment than under Extended Repayment. However, Graduated Repayment has the advantage of offering lower monthly payments during the early portion of a borrower's career when the borrower's income is likely to be lower.

The Income Contingent Repayment (ICR) Plan allows Direct Subsidized and Unsubsidized Loan borrowers to make monthly payments based on annual income and the amount of outstanding Direct Subsidized and Unsubsidized Loans. (As mentioned earlier, ICR is not available to repay Direct PLUS Loans.)

Income Contingent Repayment

To participate in the ICR Plan, a borrower (and, if married, the borrower's spouse) must sign a form that permits the Internal Revenue Service to inform the Department of certain tax return information, such as adjusted gross income (AGI). Each year, the Department uses the borrower's (and spouse's) information to calculate the borrower's monthly payment.

In certain circumstances, the Department can require alternative documentation of income from borrowers and, if married, their spouses. In fact, the Department will require alternative documentation from borrowers in their first year of repayment. This documentation includes pay stubs, canceled checks or, if these are unavailable, signed statements explaining the borrowers' income sources. Borrowers also can submit

Alternative documentation

alternative documentation to request that their monthly payments be adjusted in special circumstances—for example, if the borrower (or spouse) becomes unemployed. See the *Repayment Book* for more information on alternative documentation.

**ICR
repayment
period**

The maximum repayment period is 25 years. If the borrower has made payments under the Standard Plan or the 12-year Extended Plan and then switches to the ICR Plan, those earlier payment periods are counted toward the 25-year repayment period. Earlier payment periods in other plans do not count toward the 25-year period. If the borrower has not repaid the loans after 25 years under ICR, the unpaid portion is discharged (canceled); however, currently the borrower must pay taxes on the discharged amount.

Monthly payments are recalculated annually. Borrowers pay the **lesser** of

- ◇ the amount that would have been paid if the borrower repaid the loan in 12 years, multiplied by an income percentage factor that varies with the borrower’s annual income; or
- ◇ 20% of the borrower’s discretionary income, which is the borrower’s AGI minus the poverty level for his or her family size; the poverty level is determined by published U.S. Department of Health and Human Services guidelines.

If income is less than or equal to the poverty level for the borrower’s family size, the monthly payment will be zero. If the calculated monthly payment is greater than zero but less than \$5, borrowers are required to make a \$5 monthly payment. If the monthly payment is calculated as more than \$5, borrowers must pay the actual calculated payment amount.

**ICR—
capitalization
of interest**

As noted previously, if monthly payments under ICR do not cover accruing interest, the unpaid interest is capitalized once each year. If capitalization increases the outstanding principal the borrower owes to 10% more than the original principal owed when the repayment period began, interest will continue to accumulate but will not be capitalized. The limit on the amount of interest capitalized under ICR does not apply during any periods of forbearance or during periods of deferment for Direct Unsubsidized Loans.

The Department can designate the ICR Plan for a borrower who defaults.

**Alternative
repayment
plan**

The Department may provide an alternative repayment plan if the borrower can demonstrate satisfactorily that the other repayment plans’ terms and conditions are not adequate for his or her exceptional circumstances. The Department may require evidence of exceptional circumstances.

The repayment period under an alternative repayment plan may not exceed 30 years from the date the Direct Loan enters repayment. The maximum time frame to repay does not include periods of deferment or forbearance. The terms under which interest is capitalized are the same as for the ICR Plan.

If a borrower is permitted to use an alternative repayment plan, the Department notifies him or her in writing of the plan's terms. The borrower has the option to accept the plan or choose another.

A borrower who decides the repayment plan selected no longer meets his or her needs can switch plans, as long as the new plan's maximum repayment period is longer than the period the borrower's loan has already been in repayment. The exception to this requirement is that a borrower can switch to ICR at any time.

A borrower repaying a defaulted loan under ICR may not switch plans unless he or she

- ◇ was required to make, and did make, a payment under ICR in each of the preceding three months; or
- ◇ was not required to make payments but made three reasonable and affordable payments in each of the preceding three months.

In either case, the borrower must submit a request to the Department to switch plans, and the Department must approve the request.

If a borrower pays any amount that exceeds the amount due, the excess is a prepayment. A Direct Loan borrower may prepay all or part of a loan at any time without penalty. A prepayment is applied first to any accrued charges or collection costs, then to any outstanding interest, and then to outstanding principal. If the amount of the prepayment **equals or exceeds** the monthly repayment amount under the borrower's repayment plan, the Department advances the next payment due date (unless the borrower requests otherwise) and notifies the borrower of the revised due date.

Any refunds the Department receives from a school that are due a borrower are applied against the borrower's outstanding principal. The Department notifies the borrower of any refunds.

Periods of authorized deferment or forbearance are not included in any repayment period. The actual number of payments a borrower makes or the fixed monthly repayment amounts may be adjusted over time to reflect changes in the variable interest rates.

Switching repayment plans

Prepayments

DEFERMENT

A deferment is a period during which payments of principal on Direct Loans are postponed. No interest is charged Direct Subsidized Loan borrowers. Interest accrues and is charged Direct Unsubsidized Loan and Direct PLUS Loan borrowers, who may pay the interest during the deferment or have the interest added to the loan principal (capitalized) at the deferment's end.

34 CFR 685.204

Once repayment begins, a borrower meeting certain requirements is entitled to a deferment, although the borrower must **request** one from the Department. The borrower should continue making payments on the loan until he or she receives the Department's written notice of the deferment's approval.

A deferment period begins when the condition that makes the borrower eligible for a deferment begins, such as the date the borrower becomes unemployed or enters study in a fellowship program. A deferment may be granted retroactively from the date of application for up to six months.

Effect of default

A borrower is not eligible for any deferments on a defaulted loan unless he or she has made payment arrangements satisfactory to the Department **before** the loan is transferred from the Direct Loan Servicing Center to the Department's Debt Collection Service. Borrowers should contact their Direct Loan Servicing Center to make such arrangements.

In general (see the exception on page 11-36), there are five types of deferments authorized for Direct Loans:

- ◇ in-school student status,
- ◇ study in a graduate fellowship program,
- ◇ study in an approved rehabilitation training program,
- ◇ unemployment, and
- ◇ economic hardship.

Deferment provisions listed on existing promissory notes cannot be removed. Additionally, future legislation may provide for new deferment conditions that apply to **all** borrowers.

In-school deferment

A deferment for at least half-time study at an eligible school is referred to as an "in-school" deferment. Any school that meets the definition of an institution eligible to participate in SFA Programs—whether or not the school is currently participating—is an eligible school for the purpose of

an in-school deferment. However, if a school has never been approved as eligible to participate in any SFA Program, the Department must determine whether the school meets the definition of an eligible institution before the school may certify an in-school deferment. (See Chapter 3 for additional information on institutional eligibility requirements.)

Borrowers in a residency program in dentistry may receive in-school deferments. Borrowers in **medical** internship or residency programs do not qualify but may qualify for an economic hardship deferment (see below).

A borrower may receive deferments for study in a graduate fellowship program approved by the Department.

Borrowers with disabilities may receive deferments for study in a rehabilitation training program approved by the Department.

A borrower seeking and unable to find full-time employment may obtain a deferment for up to three years. The borrower must submit the deferment request every six months, however, to affirm his or her continuing employment search.

Borrowers experiencing economic hardship may be eligible for deferments, not to exceed three years, but must submit a deferment request every 12 months to affirm continuing eligibility. Any of the following criteria qualifies a borrower for an economic hardship deferment:

- ◇ The borrower is receiving payment under a federal or state public assistance program.
- ◇ The borrower is working full time and is earning a total monthly gross income that does not exceed the greater of (1) the minimum wage or (2) the poverty line for a family of two, as determined in Section 673(2) of the Community Service Block Grant Act.
- ◇ The borrower is working full time and has an annual federal education debt burden that is at least 20% of the borrower's adjusted gross income. Defaulted loans are not included in the education debt burden unless the borrower has made satisfactory repayment arrangements (see Section 1). Additionally, the borrower's income minus the educational debt burden must be less than 220% of the greater of (1) the minimum wage rate or (2) the poverty line for a family of two.

***Internship/
residency
programs***

***Graduate
fellowships***

***Rehabilitation
training***

Unemployment

***Economic
hardship***

- ◇ The borrower is not working full time, and the borrower's total monthly gross income from all sources is less than twice the greater of (1) the minimum wage rate or (2) the poverty line for a family of two. In addition, after deducting the total monthly payments on federal education loans, the borrower's income from all sources may not exceed the larger of (1) the minimum wage rate or (2) the poverty line for a family of two.
- ◇ The borrower has been granted an economic hardship deferment under the FFEL Program or the Federal Perkins Loan Program for the same period for which the borrower is requesting an economic hardship deferment under the Direct Loan Program.

**PLUS
borrowers**

For Direct PLUS Loan borrowers, it is generally the parent—not the student—who must meet the criteria for deferment. For example, a Direct PLUS Loan borrower can receive an in-school deferment if he or she is enrolled at least half time in an eligible program of study at an eligible school. The parent is not eligible if only the student for whom the parent borrowed meets the requirements. However, as discussed below, a parent with an outstanding FFEL made before July 1, 1993 may also qualify for a deferment when a dependent student for whom the parent borrowed a PLUS Loan is enrolled in school.

**Deferments
for borrowers
with
outstanding
FFELs—
34 CFR
685.204(d)**

If, at the time of application for a Direct Loan, a borrower has an outstanding balance of principal or interest on any FFEL made, insured, or guaranteed before July 1, 1993, the borrower is eligible for additional deferments. The deferments are those available to FFEL borrowers on loans made between July 1, 1987 and June 30, 1993.

One of the additional deferments is for parents who have borrowed for dependent students. A parent qualifies for a deferment under this provision if a dependent student for whom he or she borrowed is still dependent and meets one of the following conditions:

- ◇ The student is attending an eligible school full time.
- ◇ The student is attending full time at an institution of higher education or a vocational school that is operated by an agency of the federal government.
- ◇ The student is enrolled in an eligible graduate fellowship program or in an approved rehabilitation training program for the disabled.
- ◇ The student is attending an eligible school half time **and** obtains a Federal Stafford Loan or a Direct Loan for the same

enrollment period for which the parent is applying for a deferment. **Note that this requirement differs from FFEL:** Under FFEL, there are additional requirements the student must meet in order for the parent to receive this deferment (see Chapter 10, Section 5.)

The other deferments available to borrowers with outstanding FFELs are

- ◇ serving a required internship or residency;
- ◇ temporarily totally disabled or required to provide full-time care for a disabled dependent;
- ◇ teaching in a designated teacher shortage area;
- ◇ serving in the Armed Forces, Peace Corps, Public Health Service, ACTION, or as a full-time volunteer for a tax-exempt organization;
- ◇ active duty in NOAA Corps;
- ◇ qualifying parental leave; and
- ◇ working mother.

See Chapter 10 for more information on these deferments.

FORBEARANCE

During a period of forbearance, a borrower may stop payments temporarily or make smaller payments than previously scheduled. The Department grants forbearance for a period of up to one year. Forbearance is renewable if the borrower requests it in writing and the Department approves the request.

Although borrowers are relieved of paying principal during forbearance, interest continues to accrue. If the borrower does not pay the accruing interest during the forbearance period, the interest is capitalized after the forbearance ends (see page 11-26 for a discussion of capitalization).

A borrower may receive forbearance if he or she is willing but unable to repay the loan. The borrower must request forbearance and provide

appropriate documentation showing that he or she qualifies. The Department grants forbearance if

- ◇ it determines that due to poor health or other acceptable reasons, the borrower or endorser is currently unable to make scheduled payments;
- ◇ the borrower is in a medical internship or residency or dental residency that must be successfully completed before the borrower may begin professional practice or service, or the borrower is in a medical internship or residency program or dental residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or health-care facility that offers postgraduate training;
- ◇ a Direct Subsidized or Unsubsidized Loan borrower is serving in a national service position for which the borrower is receiving a national service educational award under the National Community Service Trust Act of 1993 (**Direct PLUS Loan borrowers are not eligible for this forbearance**); or
- ◇ the borrower's or endorser's monthly payments on federal education loans are equal to or greater than 20% of the borrower's or endorser's total monthly gross income (for not more than three years).

Administrative forbearance

In certain instances, the Department grants forbearance without requiring documentation from the borrower. These circumstances include but are not limited to

- ◇ a properly granted period of deferment for which the Department later learns the borrower did not qualify;
- ◇ a period for which payments are overdue at the beginning of a deferment;
- ◇ the period from the time the borrower entered repayment until the first payment due date was established;
- ◇ the period prior to a borrower's filing a bankruptcy petition;
- ◇ a period after the Department receives reliable information indicating the borrower (or the student in the case of a parent's Direct PLUS Loan) has died or become totally and permanently disabled—until the Department receives documentation verifying those conditions; or

- ◇ a period necessary for the Department to determine a borrower's eligibility for discharge (cancellation) under the bankruptcy, closed school, or false certification provisions (see "Discharge" below).

Under certain circumstances, a borrower may qualify for forbearance without submitting documentation. For example, forbearance may be granted when the effect of a variable interest rate on a repayment schedule extends repayment past the maximum repayment term. A borrower affected by a natural disaster does not have to sign a forbearance agreement but can simply phone his or her Direct Loan Servicing Center to request forbearance.

Borrowers may also receive forbearance due to a national military mobilization but must provide supporting documentation.

The Department may grant forbearance to borrowers whose loans are delinquent or in default.

DISCHARGE

Under certain conditions, all or a portion of a borrower's loan debt may be canceled or "discharged." Discharge provisions apply to death or total and permanent disability, bankruptcy, closed schools, and falsely certified loans. Discharged loans do not count against the borrower's annual or aggregate Direct Subsidized Loan or Direct Unsubsidized Loan limits.

If a borrower dies or becomes totally and permanently disabled, the Department discharges the borrower's and any endorser's obligation to make further loan payments. A Direct PLUS Loan borrower's (or endorser's) debt also will be discharged if the student for whom the parent borrowed dies. The parent (and any endorser) continues to be obligated to repay a Direct PLUS Loan if the student becomes totally and permanently disabled.

A borrower is not considered totally and permanently disabled based on a condition that existed when the borrower applied for the loan, unless Loans permanently dismits.

PLUS Loan endorsers **are** required to repay a loan that the borrower has discharged in bankruptcy.

***Closed school discharge—
34 CFR
685.213***

Direct Subsidized or Unsubsidized Loans may be discharged if borrowers are unable to complete their programs of study because their schools closed or because the borrowers withdrew not more than 90 days before their schools closed. If one of these conditions applies to the student for whom a parent borrowed a Direct PLUS Loan, the parent's loan will be discharged. The Department discharges the obligation of the Direct Subsidized, Direct Unsubsidized, and Direct PLUS Loan borrower (and any endorser) and reimburses the borrower for any amounts already paid.

***False certification/
unauthorized payment discharge—
34 CFR
685.214***

A Direct Subsidized or Unsubsidized Loan may be discharged if the school falsely certified the borrower's eligibility or made an unauthorized payment. If one of these conditions applies to the student for whom a parent borrowed a Direct PLUS Loan, the parent's loan will be discharged. A school is considered to have falsely certified the loan if it

- ◇ falsely certified that a student had the ability to benefit from its training,
- ◇ signed the borrower's name on the loan application or promissory note without the borrower's authorization, or
- ◇ certified the eligibility of a student who would not meet employment requirements (in the student's state of residence at the time the loan was originated) in the occupation for which the training program was intended. A student would not meet employment requirements because of a physical or mental condition, age, a criminal record, or other reason acceptable to the Department.

A school makes an unauthorized payment if it endorsed the borrower's loan check (or signed the borrower's authorization for Electronic Funds Transfer) without the borrower's authorization, unless the loan proceeds were delivered to the student or applied to charges the student owed the school.

If a borrower meets the requirements for a discharge because of false certification or unauthorized payment, the Department discharges the borrower's and any endorser's obligation to make further loan payments and reimburses the borrower for any amounts already paid. Interest and collection fees, as well as loan principal, will be discharged. The Department may attempt to collect from the school the loan amount discharged, including any refund owed the student.

If otherwise eligible, a borrower whose defaulted loans are discharged under these provisions regains eligibility for SFA funds. In addition, any adverse credit history will be deleted from credit-reporting agencies' records.

The Department returns to the sender (or to the borrower's estate) any payments received after a borrower's loan has been discharged.

**Payments
after
discharge**

DEPARTMENT OF DEFENSE REPAYMENT

The Department of Defense (as an enlistment incentive) will repay a portion of a student's Direct Loan if the student serves as an enlisted person in certain specialities in the U.S. Army, the Army Reserves, the Army National Guard, or the Air National Guard. For more information, the student should contact his or her local Army or Air National Guard recruiting office. This benefit does not pertain to an individual's prior military service.

BORROWER DEFENSES

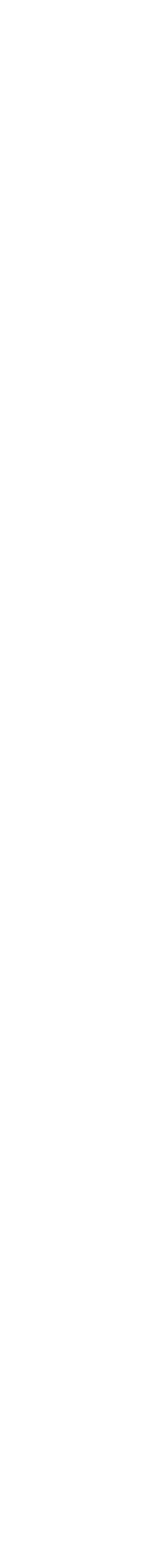
A borrower may assert a defense against repaying a Direct Loan based on any act or omission by his or her school that would give rise to a cause of action against the school under applicable state law. The borrower may assert the defense in any proceeding to collect on a Direct Loan. Collection proceedings include, but are not limited to, tax-refund offset proceedings, wage garnishment proceedings, salary offset proceedings for federal employees, and credit bureau reporting proceedings.

**34 CFR
685.206(c)**

If the borrower's defense is successful, the Department notifies the borrower in writing that he or she is relieved of the obligation to repay all or part of the loan and associated costs and fees. The Department may give the borrower further relief, as deemed appropriate, based on the borrower's circumstances. Further relief may include but is not limited to

- ◇ reimbursing the borrower for amounts paid toward the loan voluntarily and through enforced collection,
- ◇ determining that the borrower is not in default on the loan and is eligible to receive assistance from SFA funds, and
- ◇ updating information to credit bureaus in cases where the Department had made adverse credit reports about the borrower's Direct Loan.

A successful borrower's defense may result in the Department requiring the school to repay the funds and purchase the loan.



*Direct Subsidized Loans, Direct Unsubsidized Loans,
and Direct PLUS Loans 11 - 42*

Section 3

Direct Consolidation Loans

Direct Consolidation Loans allow Direct Loan and Federal Family Education Loan (FFEL) borrowers to combine one or more federal education loans and create one Direct Loan with one monthly payment. Borrowers can extend their repayment periods, thereby reducing monthly payments, and the interest rate may be lower.

TYPES OF DIRECT CONSOLIDATION LOANS

There are three types of Direct Consolidation Loans:

- ◇ Direct Subsidized Consolidation Loans,
- ◇ Direct Unsubsidized Consolidation Loans, and
- ◇ Direct PLUS Consolidation Loans.

Subsidized SFA loans can be consolidated into a Direct Subsidized Consolidation Loan. Unsubsidized SFA loans, as well as certain loans authorized under Titles VII and VIII of the Public Health Service Act (administered by the U.S. Department of Health and Human Services), can be consolidated into a Direct Unsubsidized Consolidation Loan. Direct PLUS Loans and Federal PLUS Loans can be combined into one Direct PLUS Consolidation Loan. See the chart on the following page for a list of loans that can be consolidated into each type.

Even if borrowers have loans from more than one loan type, they receive only one Direct Consolidation Loan and make just one monthly payment. However, the Department will track the parts of the Direct Consolidation Loan separately because the type of loan affects interest rates, interest subsidies, and deferment eligibility. (For example, a borrower will not be required to pay interest during a deferment on the subsidized portion of a Direct Consolidation Loan.)

Federal Education Loans Eligible for Direct Loan Consolidation

Direct Subsidized Consolidation Loans	Direct Unsubsidized Consolidation Loans	Direct PLUS Consolidation Loans
Subsidized Federal Stafford Loans	Unsubsidized Federal Stafford Loans (includes Nonsubsidized Stafford Loans made before 10/1/92)	Federal PLUS Loans
Guaranteed Student Loans (GSL)		Parent Loans for Undergraduate Students (PLUS)
Federal Insured Student Loans (FISL)	Federal Supplemental Loans for Students (SLS)	Federal Direct PLUS Loans
Federal Direct Stafford/Ford Loans	Unsubsidized Federal Consolidation Loans	Federal Direct PLUS Consolidation Loans
Federal Direct Subsidized Consolidation Loans	Federal Direct Unsubsidized Consolidation Loans	
Federal Perkins Loans	Federal Direct Unsubsidized Stafford/Ford Loans	
National Direct Student Loans (NDSL)	Auxiliary Loans to Assist Students (ALAS)	
National Defense Student Loans (NDSL)	Health Professions Student Loans (HPSL)	
Subsidized Federal Consolidation Loans	Health Education Assistance Loans (HEAL)	
	Nursing Student Loans (NSL)	
	Loans for Disadvantaged Students (LDS)	

Borrowers must consolidate at least one Direct Loan or FFEL¹ but generally are not required to consolidate all their outstanding federal education loans. For example, a borrower may choose not to consolidate a loan with an interest rate lower than a Direct Consolidation Loan's interest rate. A borrower may not, however, exclude SFA loans in default unless he or she has met the requirements for regaining SFA loan eligibility (see Section 2).

Nonfederal loans made by state or private lenders are not eligible for consolidation.

¹"Consolidating" one loan is generally done so the borrower can receive a lower interest rate or other Direct Loan Program repayment benefit.

LOAN LIMITS

There are no minimum or maximum loan limits that apply to Direct Consolidation Loans. A Direct Consolidation Loan's principal balance equals the sum of the amounts the Department pays to the holders of the loans being consolidated. The Department pays each holder the amount necessary to pay in full the loan being consolidated.

Consolidation does not increase a borrower's aggregate loan limits (see Section 2 for a discussion of loan limits). The aggregate limit for undergraduate and graduate/professional students must include any portion of a Direct Consolidation Loan used to repay a Direct Subsidized or Unsubsidized Loan, a subsidized or unsubsidized Federal Stafford Loan, or a Federal Supplemental Loans for Students (SLS) Loan.

INTEREST RATES

Direct Consolidation Loan interest rates are variable and adjusted annually on July 1. Interest rates are determined on June 1 each year and apply to the following 12-month period from July 1 to June 30.

Currently, there are two formulas for calculating the variable interest rate for Direct Subsidized and Unsubsidized Consolidation Loans:

- ◇ For loans first disbursed between July 1, 1995 and June 30, 1998 that are in **in-school, grace, or deferment periods**, the interest rate equals the bond equivalent rate of the 91-day Treasury bills auctioned at the final auction before June 1, plus **2.5** percentage points. The rate for these loans for July 1, 1997 through June 30, 1998 is 7.66%.
- ◇ For loans first disbursed between July 1, 1995 and June 30, 1998 that are **not in in-school, grace, or deferment periods**, the interest rate equals the bond equivalent rate of the 91-day Treasury bills auctioned at the final auction before June 1, plus **3.1** percentage points. The maximum interest rate is 8.25%. The rate for these loans for July 1, 1997 through June 30, 1998 is 8.25%. **Note** that this formula also applies to *any* Direct Subsidized and Unsubsidized Consolidation Loan first disbursed before July 1, 1995, in *any* period.

Currently, the interest rate for Direct PLUS Consolidation Loans equals the bond equivalent rate of the 52-week Treasury bills auctioned at the final auction before June 1, plus 3.1 percentage points. The maximum interest rate is 9%. The rate for these loans for July 1, 1997 through June 30, 1998 is 8.98%.

**Subsidized/
Unsubsidized**

PLUS

Change in interest rate calculations

Beginning July 1, 1998, interest rate calculations change. For Direct Subsidized and Unsubsidized Consolidation Loans first disbursed on or after July 1, 1998, the interest rate will equal the bond equivalent rate of the security with a comparable maturity, that the Department establishes, plus 1 percentage point. The rate will still be determined on June 1 each year and apply to the following 12-month period from July 1 to June 30. The rate will not exceed 8.25%. **This interest rate calculation applies whether or not a loan is in an in-school, grace, or deferment period.** The calculation also applies to Direct PLUS Consolidation Loans first disbursed on or after July 1, 1998, except the rate will equal the bond equivalent rate of the security with a comparable maturity, as established by the Department, plus 2.1 percentage points. The rate will not exceed 9%. Specific information on which securities' bond equivalent rates will be used was not available at the time this Handbook went to print. The Department will issue further guidance on this topic at a later date, in the form of a "Dear Colleague" Letter. When issued, this up-to-date information will also be available on the SFA BBS.

During in-school, grace, and deferment periods, the Department does not charge borrowers interest on Direct Subsidized Consolidation Loans. Interest is charged during forbearance, however. Interest is charged on Direct Unsubsidized Consolidation Loans and Direct PLUS Consolidation Loans during all periods.

Borrowers may pay the interest for which they are responsible during applicable periods or postpone paying it and have the interest capitalized (added to the principal owed). See Section 2 for a discussion of capitalizing interest.

ADDITIONAL BORROWING COSTS

No loan fee charged

Borrowers are not charged a loan fee for consolidating their loans.

Late fees

The Department can charge late fees on all or part of any payments the borrower does not pay within 30 days of the due date. The late charge may not exceed six cents for each dollar of each late installment. **Currently, however, the Department is not charging late fees.**

Collection costs

On a Direct Consolidation Loan **not** in default, the Department may require the borrower or endorser to pay any costs, in excess of routine collection costs, incurred in collecting installments not paid when due. Such charges do not include the routine costs of preparing letters or notices or making local or long-distance telephone calls. An example of a non-routine collection cost is the cost of processing checks returned for insufficient funds. On a Direct Consolidation Loan in default, the Department may require the borrower or any endorser to pay additional costs.

ELIGIBILITY

Borrowers must send a Direct Consolidation Loan application to the Department's Loan Origination Center. A single consolidation application is used, even if the borrower is consolidating more than one type of loan, such as subsidized student loans and unsubsidized student loans or subsidized student loans and PLUS Loans (if the borrower has a loan for his or her dependent student as well as a loan for him- or herself). The publication *Direct Consolidation Loans: A Guide* explains the application process in detail.

Borrowers may add pre-existing eligible loans to a newly created Direct Consolidation Loan without submitting a new application; borrowers simply submit a request to the Department within 180 days after the loan is originated (see "Subsequent Consolidation" on page 11-52).

The two types of consolidation, "regular" and "in-school," are discussed below. Basically, however, borrowers may consolidate loans any time after they are fully disbursed. Note that married borrowers may consolidate jointly. Borrowers in default also are permitted to consolidate under certain circumstances (see page 11-51). Consolidation eligibility criteria vary somewhat depending on when borrowers consolidate and whether they are in default. All Direct Consolidation Loan borrowers, however, receive the same deferment, forbearance, and discharge provisions available to borrowers of other Direct Loans (see Section 2). **Note that a borrower who consolidates a loan that is in deferment must reapply for the deferment once the loan is consolidated.**

Many borrowers consolidate when their loans are no longer in an in-school period, defined as the period before a loan enters the grace period while a borrower is enrolled at least half time at an eligible school. A loan is also considered to be in an in-school period if the borrower entered but never completed the grace period because the borrower reenrolled at least half time at an eligible school before the grace period expired.

Regular Consolidation

Borrowers consolidating at least one fully disbursed Direct Loan or FFEL, none of which is in an in-school period,² may consolidate under what is known as the regular Direct Consolidation Loan process. Borrowers may also include other student loans, such as Federal Perkins Loans and eligible health professions student loans (see the chart on page 11-44).

²Do not confuse "in-school period" with the borrower's enrollment status. A borrower can be enrolled in an eligible school at least half time and still consolidate under the regular Direct Consolidation Loan process. For example, a borrower who enrolled full time in an eligible school but had two FFELs in repayment before enrolling would qualify under the regular consolidation process. It is the status of the loans being consolidated that must be considered.

Applying

**Definition of
in-school
period**

(The status of the Direct Loan or FFEL to be consolidated determines whether the borrower has a regular or an in-school consolidation loan.)

**Borrowers
with no
Direct Loans**

A borrower with an outstanding FFEL but no outstanding Direct Loan must meet one of two conditions to receive a regular Direct Consolidation Loan: The borrower must be unable to obtain a Federal Consolidation Loan after checking with a lender that makes such loans; **or**, if the borrower is eligible for the Income Contingent Repayment Plan (see Section 2), he or she must be unable to obtain a Federal Consolidation Loan with acceptable income-sensitive repayment terms after checking with a lender that makes Federal Consolidation Loans.

**Married
borrowers
consolidating
jointly**

For married borrowers who want to consolidate jointly, only **one** borrower must meet the conditions described in the preceding paragraph. Joint consolidators are held jointly and severally liable for their consolidation loan, however. **Both** borrowers must qualify for deferment, forbearance, and discharge, unless a discharge is due to school closure or false certification. In those two cases, only **one** borrower has to qualify; however, only the portion of the Direct Consolidation Loan affected by the school closure or false certification can be discharged.

Nicholas receives two FFELs while attending Asta Institute. Nicholas withdraws from Asta, enrolls in Fribitz Institute, and takes out another FFEL. He and his wife Nora decide to consolidate her Direct Loans and his FFELs into a joint Direct Consolidation Loan. Fribitz closes three months later. Nicholas is eligible to have his FFEL at Fribitz canceled, but he and Nora will continue to be responsible for his other two FFELs that are part of the Direct Consolidation Loan—those loans are unaffected by Fribitz's closure.

TIP: Counsel married borrowers to decide carefully about joint consolidation. If one spouse dies or becomes totally and permanently disabled, for example, the other spouse is responsible for paying the entire consolidation loan. The loan would be discharged for a single borrower in such situations. Each spouse may want to consolidate separately to minimize risk.

**No grace
period**

Regular consolidation requires that borrowers (**both** borrowers, if married and consolidating jointly) have no federal consolidation loan applications pending with any other lenders (for example, a FFEL Program lender). Also, borrowers must agree to notify the Department of any address change.

A regular consolidation loan's repayment period begins the day the first disbursement is made; the first payment is due within 60 days of that date, unless the borrower is in deferment on the consolidation loan. There is no grace period.

Borrowers in repayment on any loans to be consolidated should continue making payments to their current loan holders until receiving written notice from the Department that it has consolidated their loans. Once the loans are consolidated, any payments a borrower makes to the original holders will be sent to the Department to reduce the Direct Consolidation Loan balance.

In-School Consolidation

In-school consolidation requires borrowers to meet the requirements for regular consolidation, with some exceptions.

Unlike regular consolidation, borrowers eligible for in-school consolidation may consolidate **only** Direct Loans or FFELs; the other types of federal education loans listed in the chart on page 11-44 may be consolidated only after borrowers leave school.

Borrowers attending Direct Loan schools must consolidate at least one fully disbursed Direct Loan or FFEL that is **in an in-school period** (see the definition of in-school period on page 11-47). Borrowers attending non-Direct Loan schools must have a Direct Loan **and** must consolidate a Direct Loan or FFEL that is in an in-school period. (Note that borrowers can qualify simply by consolidating one Direct Loan that is in an in-school period.) Married borrowers who wish to consolidate jointly must **both** have Direct Loans or FFELs in in-school periods. If a married borrower attends a Direct Loan school but the spouse attends a non-Direct Loan school, the spouse must have a Direct Loan and must consolidate a FFEL or Direct Loan in an in-school period. (The spouse can qualify simply by consolidating one Direct Loan that is in an in-school period.)

Borrowers with no Direct Loans who want to consolidate FFELs must be attending Direct Loan schools. (At least one FFEL must be in an in-school period.) Such borrowers do not have to certify that they have been unable to obtain Federal Consolidation Loans—FFEL borrowers currently are not permitted under the Federal Consolidation Loan Program to consolidate a loan in an in-school period.

The examples on the next page show how in-school consolidation works.

IN-SCHOOL CONSOLIDATION EXAMPLES

- Emma is in her third year at Woodhouse College (a Direct Loan school). She is a three-quarter-time student and wants a Direct Consolidation Loan for the two FFELs she received for the previous two years at a different school. The two FFELs have not yet entered repayment. Emma has no Direct Loans at Woodhouse.

Emma is eligible to receive a Direct Consolidation Loan for her FFELs because she is attending a Direct Loan school and has a fully disbursed FFEL in an in-school period.

- Elizabeth is in her first semester at Bennet University (a Direct Loan school) and is enrolled full time. Elizabeth has three FFELs she received before she transferred to Bennet (these loans are still in an in-school period) and a Direct Loan she has received at Bennet. She will receive the second disbursement of her Direct Loan in her second semester. Elizabeth wants to consolidate all four loans for convenience.

Elizabeth can receive a Direct Consolidation Loan only for the three FFELs. The Direct Loan cannot be included because it has not been fully disbursed. She may want to apply for consolidation after her Direct Loan is fully disbursed so that all four loans can be consolidated.

- Robert has a Direct Loan he received two years ago at Huntingdon College. He had been repaying that loan before enrolling at Locksley Institute, where he has been attending full time for two years. He has an in-school deferment for his Direct Loan. He received a FFEL for his first year of attendance at Locksley, which does not participate in Direct Loans. He would like to receive a Direct Consolidation Loan for both loans.

Robert may receive a Direct Consolidation Loan for both loans. He has a Direct Loan (the fact that the loan is not in an in-school period does not matter), and he has a FFEL in an in-school period.

- Diana attended Trundle University her first two years of school but has transferred to National College (a Direct Loan school) and is enrolled less than half time. She has two FFELs she received from Trundle. Diana wants to receive a Direct Consolidation Loan for the FFELs because the interest rate would be more advantageous.

Diana cannot receive an in-school Direct Consolidation Loan because she does not have at least one Direct Loan or FFEL in an in-school period (her enrollment as a less-than-half-time-student means her loans are not in an in-school period). Diana could qualify for a regular Direct Consolidation Loan if, after checking with a FFEL lender that makes Federal Consolidation Loans, she cannot receive such a loan or cannot receive one with acceptable income-sensitive repayment terms.

- Allen graduated from Hart University with a degree in Biology. He received two FFELs during his attendance. Three months after graduation, he enrolls at Sarven Technical Institute as a three-quarter-time student to pursue a degree in Zoology. Sarven is a Direct Loan school, but he has not taken out a Direct Loan. He would nevertheless like to receive a Direct Consolidation Loan for his FFELs because the repayment terms would be more favorable.

Allen may receive a Direct Consolidation Loan for his FFELs. The loans are considered to be in an in-school period because Allen has reenrolled in school at least half time after only three months of his grace period have expired.

The borrower of an in-school Direct Consolidation Loan receives a six-month grace period on the loan when he or she reduces enrollment to less than half time at an eligible school. If the underlying loan(s) that is in an in-school period enters the grace period after the Direct Consolidation Loan application's submission but before the consolidation loan's first disbursement, borrowers do not have to make payments on the loan for the amount of time remaining in the grace period at the time of the first disbursement.

On September 1 of his senior year at Gibbs College, a Direct Loan school, Joseph applies for an in-school Direct Consolidation Loan for two FFELs he has received. Two weeks after he applies, he drops below half-time attendance. Joseph has not received his first Direct Consolidation Loan disbursement. He receives the first disbursement in early December. By that time, he has used 2 1/2 months of his grace period. Joseph has 3 1/2 months left in his grace period before he must begin repayment on his Direct Consolidation Loan.

PLUS Loan Consolidation

A parent who wants to consolidate Direct PLUS or Federal PLUS loans must have at least one Direct PLUS Loan or have at least one Federal PLUS Loan and have been unable to obtain a Federal Consolidation Loan.³ The borrower must pass a credit check or must either document extenuating circumstances or obtain an endorser who can pass a credit check. (See Section 2 for more information on these topics.) If married borrowers are consolidating PLUS loans jointly, only **one** borrower needs to pass a credit check.

Consolidating Defaulted Loans

Generally, defaulted student loans may be consolidated if borrowers agree either to repay the Direct Consolidation Loan under the Income Contingent Repayment Plan or make satisfactory repayment arrangements with the current loan holder.⁴ However, the borrower has only **one** option—to make satisfactory repayment arrangements with the current loan holder—in the following two situations:

- ◇ The borrower has a defaulted loan and at least one Direct Loan or FFEL in an in-school period and wants an in-school consolidation loan, or
- ◇ The borrower wants to consolidate a defaulted PLUS Loan.

³A parent borrower is not eligible for a Direct Consolidation Loan based on being unable to obtain a Federal Consolidation Loan with acceptable income-sensitive repayment terms—Direct PLUS Loan borrowers are not eligible for the Income Contingent Repayment Plan.

⁴A borrower with student loans who does not have a Direct Loan must be unable to obtain a Federal Consolidation Loan or be unable to obtain one with acceptable income-sensitive repayment terms.

Satisfactory repayment

For purposes of consolidating a defaulted Direct Loan, FFEL, or Perkins Loan, satisfactory repayment arrangements are defined as **three** consecutive, voluntary, on-time, full monthly payments that are reasonable and affordable given the borrower's total financial situation. Borrowers eligible to consolidate defaulted health professions loans must contact the loan holders to determine how a satisfactory repayment arrangement is defined.

Excluding defaulted loans

Borrowers may not exclude a defaulted SFA loan from consolidation unless they have made repayment arrangements satisfactory to **regain SFA eligibility**. For Direct Loans and FFELs, these arrangements are the same as those described above, except borrowers must make **six** payments instead of three. For Perkins Loans, borrowers must repay the loan in full or sign a new repayment agreement and make one payment each month for six consecutive months. Note that regaining SFA eligibility does not apply if only health professions loans are in default.

Collection costs for defaulted loans

For defaulted Direct Loans and FFELs, collection costs up to a maximum of 18.5% of the outstanding principal and interest may be added to the outstanding principal loan balance. For defaulted Perkins Loans and health professions loans, collection costs equal to the amount the borrower owes may be added to the outstanding principal loan balance.

Judgments

In general, a borrower may not consolidate **any** loan on which a judgment has been obtained. For example, a borrower with a judgment on a defaulted Direct Loan, FFEL, or Perkins Loan who makes satisfactory repayment arrangements on the judgment for purposes of regaining SFA eligibility may still not include the judgment in a Direct Consolidation Loan. A borrower with a judgment on a health professions loan who is not in default on any SFA loan may consolidate all loans except the judgment.

Note that borrowers who have judgments on Direct Loans or FFELs but who rehabilitate those loans may include them in a Direct Consolidation Loan. (See Section 4 for a discussion of rehabilitation.) Rehabilitation is **not** an option for Perkins Loans and health professions loans.

SUBSEQUENT CONSOLIDATION

A borrower may add pre-existing eligible loans to a Direct Consolidation Loan within 180 days after the date the Direct Consolidation Loan is made. A pre-existing eligible loan is one fully disbursed before the Direct Consolidation Loan's first disbursement is made. A borrower who listed the pre-existing loan as an outstanding debt on the consolidation application may telephone the Loan Origination Center to request that the loan be added. A borrower who did not list the loan must submit a brief written request that includes the loan information the consolidation application requires.

After the Department verifies the additional loan, the borrower must sign a promissory note for the additional amount before the Department will pay off the holder. The loan disclosure issued when the subsequent consolidation is completed will include the balance of the newly consolidated loan.

If the original Direct Consolidation Loan required an endorser on the PLUS portion of the loan and the borrower is adding a PLUS loan, the same endorser must be used for the added PLUS loan. If an endorser was not originally required but is required for the added PLUS Loan, the endorser must agree to repay the **entire** Direct PLUS Consolidation Loan.

A borrower who wants to consolidate additional eligible loans after 180 days must complete a new Direct Consolidation Loan application.

REPAYMENT

As mentioned earlier, a regular Direct Consolidation Loan's repayment period begins the day the loan is first disbursed. If a Direct Consolidation Loan includes at least one Direct Loan or FFEL that is in an in-school period at the time the Department receives the consolidation application, the repayment period begins the day after the grace period ends.

The first payment on a Direct Consolidation Loan is due within 60 days of the loan's first disbursement, unless a borrower is eligible for a deferment or the loan includes at least one Direct Loan or FFEL in an in-school period and therefore qualifies for a grace period.

Direct Loan repayment plans and their requirements also apply to Direct Consolidation Loans. See Section 2.

Borrowers may not choose the Income Contingent Repayment Plan for Direct PLUS Consolidation Loans. Borrowers with these loans may have two repayment plans if they want to repay their Direct Subsidized Consolidation Loans and/or Direct Unsubsidized Consolidation Loans under the Income Contingent Repayment Plan.

The length of a Direct Consolidation Loan repayment period under each plan is the same as for non-consolidated Direct Loans. See Section 2 for a list of the plans' maximum repayment periods.

Section 2, page 11-31, shows the repayment period for the Extended and Graduated repayment plans, based on the borrower's outstanding loan balances. For Direct Consolidation Loans, outstanding balances consist of all the borrower's Direct Consolidation Loans, Direct Loans, and other education loans not made by an individual and not in default (unless satisfactory repayment arrangements have been made [see Section 2]). The

**Repayment
plans**

**Repayment
period length**

total outstanding balance for the other education loans used to determine an Extended or Graduated repayment period may not exceed the amount of the Direct Consolidation Loan.

**Repayment
schedule**

The Department forwards a repayment schedule to the Direct Consolidation Loan borrower before the first installment payment is due. The schedule presents the borrower's monthly repayment under the repayment plan selected. If a borrower then adds an eligible loan to the consolidation, the Department adjusts the monthly repayment amount (and, if necessary, the repayment period for loans in Graduated or Extended repayment plans).

**Switching
plans**

As is true for Direct Loans, a borrower who decides the repayment plan selected for the Direct Consolidation Loan no longer meets his or her needs can switch plans by calling or writing the Direct Loan Servicing Center—as long as the new plan's maximum repayment period is longer than the period the borrower's loan has already been in repayment.

A borrower who had a defaulted loan and became eligible for a Direct Consolidation Loan by agreeing to repay it under the Income Contingent Repayment (ICR) Plan may switch to a plan other than ICR if he or she

- ◇ was required to make, and did make, a payment under ICR in each of the prior three months; or
- ◇ was not required to make payments but made three reasonable and affordable payments in each of the prior three months.

In either case, a borrower must call or write the Direct Loan Servicing Center to receive permission to make such a switch.

HOLDER RESPONSIBILITIES

When a borrower wishes to consolidate a FFEL or other non-Direct Loan, the loan holder must certify the loan amount and forward that information to the Department within 10 business days of receiving the Department's request for loan information. A loan holder that is unable to provide the certification must explain the reason in writing to the Department.

The holder must promptly use the Direct Consolidation Loan proceeds received from the Department to discharge fully the borrower's obligation on the loan that has become consolidated.

- ◇ If the amount the Department pays exceeds the amount owed, the loan holder must refund the excess to the Department to be credited against the outstanding balance of the Direct Consolidation Loan.
- ◇ If the amount the Department pays is insufficient to pay off the loan, the holder must notify the Department in writing of the amount due so that the remainder can be paid.

The holder also is responsible for notifying the borrower that the original loan has been paid in full.

If a holder of a loan that was consolidated receives a refund from a school on that loan, the holder must transmit the refund to the Department within 30 days of receipt. The holder must include an explanation of the refund source.

Refunds from schools

Section 4

Default

The first part of this section discusses default's effect on borrowers and actions they can take to regain eligibility for SFA funds. The second part deals with default from the school's perspective and presents information on cohort default rates and the consequences for schools with rates above certain levels.

DEFAULT'S EFFECT ON BORROWERS

If borrowers fail to make any installment payment when due, the loan becomes delinquent. The Direct Loan Servicing Center makes repeated attempts to contact borrowers by telephone and letter, uses skip-tracing techniques and the assistance of other government agencies to locate borrowers if their whereabouts become unknown, and resolves repayment problems with delinquent borrowers to prevent defaults. Borrowers (or endorsers, if applicable) who become delinquent or default may be required to pay collection costs.

Borrowers are in default if the loan becomes 180 days delinquent (or if they fail to meet other terms of the promissory note for 180 days) and the Department concludes they do not intend to honor their obligation to repay.

The Department will "accelerate" a defaulted loan, that is, declare the entire balance and accrued interest immediately due and payable.

The Department may take any action authorized by law to collect a defaulted Direct Loan, including

- ◇ filing a lawsuit against the borrower,
- ◇ reporting the default to national credit bureaus,
- ◇ requesting the Internal Revenue Service to offset the borrower's federal income tax refund, and
- ◇ garnishing the borrower's wages.

Definition of default

Department actions against borrowers who default

Before reporting the default to a national credit bureau or assessing collection costs, the Department gives the borrower written notice of its proposed actions, an opportunity to enter into a repayment agreement, and an opportunity for a review of the loan's status. Once the Department notifies a credit bureau of a borrower's default, the credit bureau may provide credit inquirers with that information for up to seven years from the date the loan is first reported as a default or, for a borrower who reenters repayment and again allows the loan to default, up to seven years from the date of the second default.

The Department may designate the Income Contingent Repayment Plan for a borrower who defaults on a Direct Subsidized or Unsubsidized Loan or a Direct Subsidized or Unsubsidized Consolidation Loan. (The Income Contingent Repayment Plan is not available for Direct PLUS Loans and Direct PLUS Consolidation Loans.) Further, a borrower in default cannot receive deferments, except in the limited circumstances described on page 11-34. However, forbearance may be available.

***Reinstatement
of borrower
eligibility***

Borrowers in default are ineligible for SFA funds but can take certain actions to have eligibility reinstated. As mentioned in Section 1, a borrower may repay a defaulted loan in full or make satisfactory repayment arrangements, defined as six consecutive, voluntary, on time, full monthly payments that are reasonable and affordable given the borrower's financial situation. "On time" means a payment made within 15 days of the scheduled due date. "Voluntary" payments are those the borrower makes directly, whether or not a judgment exists. Voluntary payments do not include those obtained by income tax offset, garnishment, or income or asset execution. For purposes of regaining eligibility, a student may make satisfactory repayment arrangements on a defaulted Direct Loan only once. For purposes of consolidating a defaulted loan, three payments are required instead of six; generally, a borrower may instead agree to repay the consolidation loan under the Income Contingent Repayment Plan. For more information on consolidating defaulted loans, see Section 3.

If a borrower regains eligibility during an enrollment period (for example, if the sixth payment under a satisfactory repayment arrangement is made after the start of an enrollment period), the borrower regains eligibility for the entire loan period.

***Requesting
forbearance
while in
school***

A borrower who makes satisfactory repayment arrangements and regains SFA eligibility must continue to make payments on the defaulted loan. (A borrower who is unable to do so while attending school should request forbearance on the loan—as mentioned above, deferment is generally not an option for borrowers in default. See Section 2 for a discussion of forbearance.)

If a borrower whose loan is in default makes 12 consecutive, on time, reasonable, and affordable monthly payments under a satisfactory repayment agreement (which may include the six consecutive monthly payments necessary to regain SFA eligibility), the loan is “rehabilitated.” In such a case, the Department instructs any credit bureau to which the default was reported to remove the default from the borrower’s credit history. The borrower is eligible for SFA funds, and regains eligibility for deferments.

Rehabilitation

A loan on which collection activities have ceased because the Department has not been able to collect is still considered a defaulted loan for purposes of borrower eligibility. A borrower who wishes to borrow again under the Direct Loan Program must “reaffirm” the loan amount and make satisfactory repayment arrangements, as previously described. Because reaffirmation means legal acknowledgment of the loan, the borrower may have to sign a new promissory note or repayment schedule. Reaffirmed loans count toward a borrower’s aggregate loan limits (see Section 2 for a discussion of loan limits).

Reaffirmation

A borrower whose loan obligation is discharged in bankruptcy after the borrower has defaulted is again eligible for SFA Program funds (see Section 1).

The *Institutional Student Information Record (ISIR)*, *Student Aid Report (SAR)*, or *SAR Information Acknowledgement* alerts schools that a borrower is in default on a federal education loan and is not eligible for federal financial aid. If the borrower has made satisfactory repayment arrangements, these documents will indicate the borrower is eligible for a loan but will include a warning that if scheduled payments are not made on the previous loan, future federal student aid will be denied. This information should be reconciled with documentation from the Direct Loan Servicing Center stating that repayment requirements continue to be satisfied. Schools must keep this documentation in the student’s file. Once the information is reconciled, the student’s eligibility for federal student aid funds can be evaluated.

Sources of information about a borrower’s default

A borrower’s financial history, which includes information about default, results from a data match between the Central Processing System (CPS), which processes data from the *Free Application for Federal Student Aid (FAFSA)*, and the National Student Loan Data System (NSLDS). For more information on the NSLDS, see Chapter 2, Section 2.

DEFAULT'S EFFECT ON SCHOOLS

Cohort default rates

Because FFEL Program cohort default rates have been a useful measure of institutional performance and an effective means of reducing defaults by removing high default schools from the FFEL Program, the Department has established a similar cohort default rate measurement for the Direct Loan Program. Definitions of “cohort default rate” and “institutional eligibility requirements” for the Direct Loan Program are based on the percentage of a school’s former students who default on Direct Loans.

Each year, the Department gives schools draft cohort rates along with the Department’s *Draft Cohort Default Rate Review Guide*. After schools have reviewed their rates and had a chance to resolve any errors with the Department, the Department publishes the official cohort rates and notifies schools of their rates. A school that does not challenge the data during the draft data review process may not challenge that same data at any other time.

Official cohort rates are based on the number of a school’s former students who enter repayment in one fiscal year and default before the end of the next fiscal year. For purposes of a school’s Direct Loan cohort rate, a Direct Loan is considered in default when the borrower’s (or endorser’s) failure to make an installment payment when due persists for 270 days. For non-degree-granting proprietary institutions, a loan is also considered in default if the student has been in repayment under the Income Contingent Repayment Plan for at least 270 days with scheduled payments of less than \$15 and less than the monthly interest accruing on the loan.

A student who receives a Direct Loan from one school, later transfers and receives another Direct Loan, and subsequently defaults on both loans will count in **each** school’s default rate.

Public, Private Nonprofit, or Proprietary Degree-Granting Schools

For any fiscal year during which **30 or more** current and former students at a school enter repayment on Direct Loans used for attendance at the school (or enter repayment on the portion of a Direct Consolidation Loan used to repay those loans), the Direct Loan Program cohort default rate is the percentage of students who enter repayment in that fiscal year whose loans are in default before the end of the following fiscal year.

The following is an example of how the cohort default rate is calculated for a school with **30 or more** borrowers in repayment.

For any fiscal year in which **fewer than 30** of the school's current or former students enter repayment as described above, the Direct Loan

In FY 1995, 80 current and former Direct Loan borrowers at Bylsma Conservatory entered repayment on their loans. By the end of FY 1996, 20 of those students, or one-fourth, had defaulted. Bylsma Conservatory's FY 1995 cohort default rate is 25%.

The formula for calculating a cohort default rate for schools with 30 or

Program cohort default rate is the percentage of those students who

- ◇ entered repayment in any of the three most recent fiscal years, and
- ◇ whose loans are in default before the end of the fiscal year immediately following the fiscal year in which they entered repayment.

The example below shows how the cohort default rate is calculated for a school with **fewer than 30** borrowers in repayment. Because a cohort default rate calculation was not done for Direct Loans until FY '95, the years in this example will be projected; the principle is the same, however.

A cohort default rate is like a snapshot of the time period affected. Changes that occur after the data for a particular cohort default rate are collected will not affect that default rate calculation. To illustrate, let's take Bylsma Conservatory's FY 1995 cohort default rate. Those students who enter repayment in FY 1995 (10/1/94—9/30/95) and default before the end of FY 1996 (10/1/95—9/30/96) are counted in Bylsma's FY 1995 cohort default rate. Here are examples of three students who attended Bylsma and who subsequently defaulted:

- ◇ Anner entered repayment in October 1994 and subsequently defaulted in May 1996. He won \$10,000 in a lottery in November 1996 and promptly repaid his loan in full. Nevertheless, Anner will continue to be counted as being in default in Bylsma's FY 1995 cohort default rate calculation.
- ◇ Olivia defaulted in July 1996 but made satisfactory arrangements to repay her loan in December 1996. For purposes of calculating Bylsma's FY 1995 cohort default rate, Olivia continues to be counted as in default.
- ◇ Jesse made payments on a loan that entered repayment in FY 1995. In spring 1996, Jesse lost his job; unable to find another, he defaulted on his loan in November 1996. Because Jesse's default occurred after the FY 1995 cohort default rate calculation period ended (after September 30, 1996), his loan was reported only as being in repayment. Jesse's loan is not counted as a default in *any* fiscal year's cohort default rate calculation.

Proprietary Non-Degree-Granting Schools

For any fiscal year during which **30 or more** current and former students at the school enter repayment as described on page 11-60, the Direct Loan Program cohort default rate is the percentage of those students

- ◇ who enter repayment in that fiscal year whose loans are in default before the end of the following fiscal year, or
- ◇ who, before the end of that following fiscal year, have for 270 days been in repayment under the Income Contingent Repayment Plan, with scheduled payments that are less than \$15 a month and less than the interest accruing on the loan.

The following is an example of how the cohort default rate is calculated for a non-degree-granting proprietary school with **30 or more** borrowers in repayment.

In FY 1995, 80 current and former Direct Loan borrowers at Guerrero Technical Institute entered repayment on their loans. By the end of FY 1996, 20 of those students, or one-fourth, had defaulted. In addition, 8 of those students were repaying loans under the ICR plan and had the low payments described above for 270 days.

The formula for calculating a cohort default rate for schools with 30 or more borrowers entering repayment is

$$\frac{\begin{array}{l} \text{Number of students who entered repayment in FY A} \\ \text{who default by the end of FY B (the following FY)} \\ + \text{ Number of students who entered repayment in} \\ \text{FY A who had specified low ICR payments for 270 days} \end{array}}{\text{Number of students who entered repayment in FY A}} \times 100 \text{ percent}$$

Guerrero's default rate is 35% (20+8/80 X 100 percent = 35%.)

For any fiscal year in which **fewer than 30** of the school's current or former students enter repayment as described previously, the Direct Loan Program cohort default rate is the percentage of those students

- ◇ who entered repayment in the three most recent fiscal years whose loans are in default before the end of the fiscal year immediately following the year in which they entered repayment, or
- ◇ who, before the end of that following fiscal year, have for 270 days been in repayment under the Income Contingent Repayment Plan, with scheduled payments that are less than \$15 a month and less than the interest accruing on the loan.

The example below shows how the cohort default rate is calculated for a non-degree-granting proprietary school with **fewer than 30** borrowers in repayment.

Benoit Institute had 15 borrowers who entered repayment in FY 1995; 10 of those defaulted by the end of FY 1996, and 3 had the low ICR payments described above for 270 days. Benoit had 25 borrowers entering repayment in FY 1996; 5 of those defaulted by the end of FY 1997, and none had low ICR payments. Benoit had 20 borrowers entering repayment in FY 1997; 5 of those defaulted by the end of FY 1998, and 1 had the low ICR payments. Benoit's FY 1997 cohort default rate would be calculated as follows:

$$\begin{array}{rcccccc} \text{FY 1995} & & \text{FY 1996} & & \text{FY 1997} & & \\ 10+3 & + & 5+0 & + & 5+1 & = & 24 \\ 15 & + & 25 & + & 20 & = & 60 \end{array} \times 100 \text{ percent}$$

Benoit's default rate is 40% (24/60 X 100 percent = 40%.)

Weighted Average Cohort Rate (Dual-Program Cohort Rate)

If there are both FFELs and Direct Loans entering repayment in the school's cohort, the Department calculates a **weighted average cohort rate**, also known as a **dual-program cohort rate**. The Department bases this rate on the number of borrowers, not the number of loans. For example, if a borrower enters repayment on both FFELs and Direct Loans in the same cohort, the student will be counted only once in the calculation used to determine the cohort default rate. A summary of borrowers included in the types of cohort default rates is presented below.

Type of School	Type of Rate	Defaulted Borrowers	ICR Component
Public, private non-profit, and degree-granting proprietary institutions	• Direct Loan Program Cohort Rate	Yes	No
	• Weighted Average Cohort Rate	Yes	No
Non-degree-granting proprietary institutions	• Direct Loan Program Cohort Rate	Yes	Yes
	• Weighted Average Cohort Rate	Yes	Yes

Once the number of borrowers in the cohort is determined, the calculation of the weighted average is similar to the calculation of the Direct Loan Program cohort default rate just described.

Cohort Default Rates for Schools that Change Status

Default reduction measures apply to **all** divisions and locations of a school. If a school changes its status (by branching, consolidating, or changing ownership, for example) the Department will track and impose

appropriate consequences for cohort default rates for fiscal years both before and after the change in status.

If a location becomes a free-standing school:

A school that is a location of a proprietary vocational or vocational postsecondary school and that is seeking institutional eligibility in its own right, is required to operate independently from its former “parent” school for at least two years before it is eligible to participate in SFA Programs.

If a school changes ownership:

If the new owner applies for eligibility to participate in the SFA Programs as a continuation of the old school, the new owner remains responsible for the school’s cohort default rates and for implementing any requirements associated with those rates. New owners should be aware that cohort default rates calculated for fiscal years prior to the change of ownership may affect the school’s ability to participate in SFA Programs. In fact, a school undergoing a change of ownership may be refused certification for participation in any SFA Program or may be granted provisional certification on the basis of current cohort default rates.

The Department is required by law to use procedures that prevent a school from evading the application of a cohort default rate determination through such measures as branching, consolidation, change of ownership or control, or other similar device. Specific information on how cohort default rates for prior fiscal years are used for eligibility determinations following a change in status for a school was not available at the time this Handbook went to print. The Department will issue further guidance on this topic in the form of “Dear Colleague” Letters. When issued, this up-to-date information will also be available on the SFA BBS.

Consequences Associated with Official Cohort Default Rates Above Certain Thresholds

When the Department sends schools their official cohort default rates, it will include a warning for schools with rates above 20% that they are in danger of facing sanctions.

If a school has a combination of a FFEL Program cohort default rate, Direct Loan Program cohort rate, or weighted average cohort rate of 25% or greater for the three most recent consecutive fiscal years for which data are available, the school loses its eligibility to participate in the Direct Loan Program and is subject to Limitation, Suspension, and Termination (LS&T) action against participating in the FFEL Program. A school also

Cohort default rates of 25% or greater for three consecutive years

can lose its eligibility for the Direct Loan Program on the basis of a high FFEL Program cohort default rate. A school ceases to be eligible to participate in Direct Loans beginning 30 days from the date it receives notice of its loss of eligibility, unless it successfully appeals the loss of eligibility on the basis of erroneous data or exceptional mitigating circumstances.

The Department places an ineligible school on the reimbursement system of payment until the 30th day following the date the school receives notification of its eligibility loss or, if the school appeals, until the appeal is decided. The Department removes a school from reimbursement if the school's appeal is successful. If the appeal is denied, the school is not eligible to participate in the Direct Loan Program for the remainder of the current fiscal year plus the following two fiscal years.

A school that loses eligibility must immediately inform all current and potential students and must make clear that they cannot receive Direct Loans or FFELs for attendance at the school. However, students who receive a first disbursement on a Direct Loan or FFEL before the school loses eligibility may receive subsequent disbursements on those loans. Students attending the school remain eligible for in-school deferments.

Schools not subject to loss of eligibility

Historically black colleges and universities (HBCUs), community colleges that Native American nations control ("tribally controlled"), and Navajo community colleges will not lose Direct Loan Program eligibility because of default rates greater than 25% for the three most recent fiscal years for which data are available. This exemption for these schools extends to July 31, 1998.

To remain eligible to participate in the Direct Loan Program, strict standards must be met for appeals, as explained below. More comprehensive information is provided in the Department's official cohort default rate notification letter and the *FY 1995 Official Cohort Default Rate Guide*. Schools must keep the official default-rate notification letter for program review and audit purposes.

Cohort default rates that exceed 40%

The Department may take LS&T action against a school's participation in all SFA Programs if the school has a Direct Loan Program cohort rate—or, if applicable, a weighted average cohort rate—greater than 40% for a fiscal year. A school's only acceptable defense against such an LS&T action is that the rate is not final. If a hearing officer determines that the cohort default rate on which the proposed LS&T action is based is not the final rate as determined by the Department and that the correct rate would be less than 40%, the LS&T sanction will not be imposed.

Appeal Procedures for Schools with High Official Cohort Default Rates

The type of default rate appeal a school may submit varies depending on the school's default rate category. Schools must follow the appeal time frames and standards set forth in the *FY 1995 Official Cohort Default Rate Guide*, or they will be prohibited from challenging their default rates.

Schools subject to loss of Direct Loan eligibility (those schools with cohort default rates of 25% or greater for the three most recent fiscal years) may appeal on the basis of erroneous data or exceptional mitigating circumstances. Schools subject to loss of all SFA eligibility (those schools with default rates above 40%) may appeal only on the basis that the default rate is not the final rate determined by the Department and that the correct rate would be less than 40%.

Erroneous Data

A school may appeal on the grounds that the calculated default rate is not accurate for any of the three fiscal years used to determine the end of the school's participation in Direct Loans, and that if the Department recalculated using corrected data, the rate would be less than 25% for any of the three relevant fiscal years. A school must submit an appeal, in writing, to the Department no later than the 30th calendar day following the date the school receives notification of the end of its Direct Loan participation. A school cannot use alleged errors in the draft cohort default rate that were not challenged in the draft review process as a basis for an appeal.

Exceptional Mitigating Circumstances

A school may appeal under one (or both) of the exceptional mitigating circumstances that the Department recognizes would make the school's loss of eligibility inequitable (see below). An appeal submitted based on these circumstances must contain an attestation from an independent auditor that the statements the school's management makes in the appeal are complete, accurate, and determined in accordance with applicable regulations. The appeal also must contain a certification, under penalty of perjury, by the school's chief executive officer that all the information the school provides to support its appeal is correct.

The participation rate index criterion is based on a school's FFEL Program cohort default rate, Direct Loan Program cohort rate, or weighted average cohort rate and the percent of the school's regular students enrolled on at least a half-time basis who borrow under the Direct Loan Program. The rate is calculated by multiplying the school's FFEL Program cohort default

***Participation
rate index
equal to or
less than
0.0375***

**Economically
disadvantaged
background
rate**

rate, Direct Loan Program cohort rate, or weighted average cohort rate by the percent of the school's regular students enrolled at least half time who borrowed under the Direct Loan Program during a 12-month period that ended during the six months immediately preceding the fiscal year used to determine the cohort of borrowers for the school's rate. If this product is less than or equal to 0.0375, the school would meet the exceptional mitigating circumstance criterion.

A school may use the participation rate index criterion only if it has a FFEL Program cohort rate, a Direct Loan Program cohort rate or, if applicable, a weighted average cohort rate of less than 40% for the most recent fiscal year.

To be eligible under the economically disadvantaged background rate, a school must demonstrate that it **successfully** serves students from economically disadvantaged backgrounds. The school must meet the following requirements:

- ◇ at least 70% of its regular students are from disadvantaged economic backgrounds, for a 12-month period that ended during the 6 months immediately preceding the fiscal year used to determine the cohort of borrowers for the school's rate.

Note that "disadvantaged" is defined as an Expected Family Contribution (EFC) of 0 for the award year coinciding with the same 12-month period just described, or is defined as an adjusted gross income (AGI) of the student and the student's parents or spouse, if applicable, that is less than the poverty level as determined by the U.S. Department of Health and Human Services.

- ◇ at least 70% of a degree-granting school's students who were initially enrolled as full time and who were scheduled to complete their programs within the same 12-month period described previously, do complete their programs, transfer to higher level educational programs, or remain enrolled and are making satisfactory academic progress at the end of the 12-month period; and
- ◇ a non-degree-granting school had a placement rate of 50% or more with respect to its former regular students who remained in the program beyond the point the students would have received a 100% tuition refund from the institution. This rate is based on the number of students initially enrolled at least half time who were scheduled to complete their program within the same 12-month period the school has chosen to determine the percentage of students that come from disadvantaged economic

backgrounds. The rate does not include students still enrolled and making satisfactory academic progress. Students may be counted as employed only if, on the date following 12 months after the date of their last day of attendance, they are employed, or have been employed, for 13 weeks in an occupation for which the school provided training.

The Secretary issues a decision on a school's appeal within 45 calendar days after the school submits the complete appeal.

Schools should direct questions about cohort rates, the draft review process, or the appeals process to the Department's Default Management Division:

U.S. Department of Education
Default Management Division
Portals Building, Suite 6211
600 Independence Avenue, SW
Washington, DC 20202-5353
202-708-9396

Section 5

School Responsibilities

Institutional responsibilities under the Direct Loan Program largely, but not entirely, focus on the items basic to “booking” a loan (the loan origination record, promissory note, and disbursement record). Responsibilities and procedures associated with these items vary depending on the school’s origination level. Origination levels, their corresponding functions, and procedures for requesting and maintaining Direct Loan funds are covered in the Department’s *Direct Loan School Guide*. For information applicable to all schools on requesting and maintaining SFA funds, see Chapter 3.

To help schools understand other requirements and procedures necessary to administer the Direct Loan Program, the Department provides Direct Loan publications in addition to the *Direct Loan School Guide* and conducts training with accompanying written materials. Information includes the *Reconciliation Guide for Direct Loans*, user’s guides on the Department’s Electronic Data Exchange (EDE) and EDEExpress software, and trainee guides for the Department’s Direct Loan and EDEExpress workshops. This section will not repeat information covered in these materials but will focus on schools’ other Direct Loan responsibilities. For a broad discussion of institutional responsibilities, see Chapter 3.

DETERMINING THE LOAN PERIOD

The period of enrollment or loan period is the period for which the Direct Loan is intended. This period must coincide with one or more of a school’s academic terms (such as academic year, semester, trimester, or quarter) for schools that use terms. Loan periods for schools that do not use terms are generally based on the length of the program or academic year. The cost of attendance, estimated financial assistance, and Expected Family Contribution must relate to the loan period.

The **minimum** period for which a school may originate a loan is

- ◇ at a credit-hour school using standard terms (semesters, trimesters, or quarters), a single academic term, or
- ◇ at a clock-hour school or a credit-hour school using nonstandard terms or no terms, the **shortest** of the following three periods:
 - the academic year, as defined by the school in accordance with the General Provisions regulations,
 - the length of the student's program at the school, or
 - the remaining portion of the student's program that exceeds the school's academic year.

The **maximum** loan period is generally the school's academic year but cannot exceed a 12-month period.

Summer sessions overlapping award years

If a summer school session overlaps two award years (that is, begins before July 1 and ends on or after July 1), the financial aid administrator can decide to which of the two award years the loan period will apply. This is the **only** case in which a financial aid administrator has such discretion. If a student in a summer school session that overlaps two award years is also receiving campus-based aid (a Federal Perkins Loan, a Federal Supplemental Educational Opportunity Grant [FSEOG], or Federal Work-Study [FWS]), both the Direct Loan and the campus-based aid must apply to the same award year.

If a student's Direct Loan is originated after an enrollment period begins, the loan may retroactively cover the entire enrollment period, as long as that period does not exceed the maximum loan period allowed. For example, suppose a school's academic term begins on September 6 and runs through December 20. A student admitted to a program contingent on the school's receiving an acceptable academic transcript from a previous school begins the academic term on September 6. The school receives the transcript on October 15. The school may originate the loan for the full enrollment period (September 6 through December 20). If the student plans on enrolling for the subsequent term and that term is part of the same academic year as the first term, the school may originate the loan to cover the period from September 6 to the end of the second term.

If a school charges a student tuition and fees at the beginning of a program that is longer than an academic year, the cost of attendance for the Direct Loan Program should include the full amount of the tuition and fees charged in the **enrollment period** in which the loan is made. For example, suppose a school with a 1,350-clock hour program defines its academic year as 900 clock hours and charges each student the full \$3,000 in tuition and fees at the beginning of the program. An enrolling student may receive two Direct Loans during the program (provided all eligibility criteria are met) because the program exceeds one academic year. The tuition and fees component of the cost of attendance for the first Direct Loan is \$3,000; there is no tuition and fees component in the cost of attendance for the second Direct Loan. Also, the second loan must be prorated because the remainder of the program (450 hours) is shorter than the school's academic year. See page 11-19 for more information on loan proration.

Charging tuition and fees at the start of a program longer than an academic year

DISBURSEMENTS

Before disbursement, schools must take certain steps:

- ◇ The school or the Department's Loan Origination Center, depending on the school's origination level, must have a completed, signed promissory note from the borrower.
- ◇ The school must confirm the borrower's eligibility (see Section 1).
- ◇ If a student has received financial aid from another school, the financial aid administrator must request a financial aid transcript from the other school(s) or use National Student Loan Data System (NSLDS) information to ensure the student is not in default on an SFA loan and does not owe a repayment on an SFA grant. Schools also must determine the borrower's outstanding Direct Loan/FFEL balance to determine remaining eligibility. See Chapter 2, Section 2 for information on financial aid transcripts and NSLDS.
- ◇ The cash management regulations state that schools must notify students not only of the amount of SFA funds the students can expect to receive but also the amount that **parents** can expect to receive. The notice must also specify how and when students' and parents' expected SFA funds will be disbursed. If those funds include Direct Loans, schools must delineate in the notice which Direct Loan funds are subsidized and which are unsubsidized. For additional school notification requirements, see page 11-77.

Notification of funds student AND parent will receive

Cash management regulations

For a detailed discussion of cash management regulations, including the general definition of “payment period,” see Chapter 3. The discussion here covers disbursement provisions affecting Direct Loans.

Definition of disbursement

SFA funds are considered disbursed when a school credits a student’s account or pays a student or parent directly, either from SFA funds received from the Department or from school funds labeled as SFA funds before any SFA funds are received. Note that there are certain limitations on how early disbursements can be made that may affect whether a payment is considered a disbursement (see page 11-75).

Number of Disbursements

Standard term credit-hour

If a school’s program uses standard academic terms (semester, trimester, or quarter) and measures progress in credit hours, the term is the payment period, and disbursements are made as follows:

- ◇ If there is only one term, a school disburses a Direct Loan in equal amounts at the beginning of the term and at the term’s calendar midpoint. If the loan period equals one payment period and more than half the payment period has elapsed, schools may include in the disbursement the loan proceeds for the entire payment period.
- ◇ If there is more than one term, schools must disburse funds over **all terms** of the loan period. For example, if a loan period includes all three quarters of an academic year, the loan must be disbursed in three equal payments, one per quarter. Previously, quarter-based schools could have disbursed loan funds for all three quarters in two disbursements. If one or more payment periods have elapsed before a school makes a disbursement, the school may include in the disbursement the loan proceeds for the completed payment periods.

Clock hours/ nonstandard terms/ nonterm

If a school’s program measures progress in clock hours or in credit hours without using standard terms, disbursements are made as follows:

- ◇ A school disburses a Direct Loan in equal amounts. The school makes the first disbursement at the beginning of the loan period. The second disbursement may not be made, however, until the **later** of
 - the calendar midpoint between the first and last scheduled days of class of the loan period, or
 - the date (determined by the school) that the student has completed half the academic coursework (for credit hour

schools) or half the clock hours (for clock hour schools) in the loan period.

- ◇ If the calendar midpoint of the loan period has passed and the borrower has completed one-half the credit hours or clock hours in the loan period before the school makes any disbursement, the school may disburse the loan in a single installment.

Timing of Disbursements

As discussed earlier, generally an SFA disbursement occurs when a school credits a student's account or pays a student or parent directly, either from SFA funds received from the Department or from school funds labeled as SFA funds before any SFA funds are received. Schools may make the first Direct Loan disbursement 10 days before the first day of classes, except for first-time, first-year undergraduates. In these cases, schools must wait until 30 days after the first day of the student's scheduled classes. A standard-term credit hour school can make a second or subsequent disbursement 10 days before the first day of classes of any subsequent term. Second disbursements for clock hour or nonstandard-term credit hour schools are described on the previous page.

If a school pays the student (either directly or by crediting the student's account) with institutional funds more than 10 days before the first day of classes, the disbursement is considered to have occurred on the 10th day before the first day of classes. Similarly, if a school pays a first-time, first-year, undergraduate borrower with institutional funds earlier than 30 days after classes start, the disbursement is considered to have occurred on the 30th day after classes start.

If a school makes a credit and indicates on the account that the credit is a Direct Loan, the school has made a Direct Loan disbursement, as long as the timing of the credit is within the relevant periods discussed above. If a school makes a memo entry for billing purposes and does not identify it as a Direct Loan credit, the school did not make a Direct Loan disbursement.

If a student delays attending school, the school may consider the student to have maintained eligibility for the loan from the first day of the enrollment period.

If a student temporarily ceases to be enrolled at least half time before any Direct Loan funds are disbursed, the school may still make a first disbursement (and subsequent disbursement) if the student resumes enrollment at least half time. The school must review the student's cost of attendance, revising it as necessary to ensure the student still qualifies for the entire Direct Loan amount even though the cost of attendance may be lower. The school must document this review in the student's file.

Delay in attendance

Student temporarily drops below half-time status

Student no longer enrolled

If a student becomes ineligible for Direct Loans because he or she is no longer enrolled as at least a half time student for the loan period, the school may still make a disbursement to that student. Certain conditions must be met:

- ◇ The student incurred costs for the period in which the student was enrolled and was eligible.
- ◇ If the student was a first-year, first-time borrower, he or she must have completed the first 30 days of the program of study.
- ◇ The school must have a SAR or ISIR with an official EFC for the student.
- ◇ The school must have created a complete, electronic loan origination record while the student was enrolled and eligible.

The school must make the late disbursement no later than 90 days after the date the student becomes ineligible. Note: The November 29, 1996 cash management regulations provide that schools are no longer required to document exceptional circumstances in the student's file for any late disbursements made from 61 to 90 days after the student stopped attending. For a discussion of late disbursements, see Chapter 3.

The school cannot make a late second or subsequent Direct Subsidized or Direct Unsubsidized Loan disbursement unless the student has graduated or successfully completed the enrollment period for which the loan was intended.

Additional Disbursement Requirements

Written authorization

As specified in the promissory note, a school may apply Direct Loan proceeds to the student's account without the borrower's written authorization or acknowledgment. However, if a school applies payment to charges other than current tuition, fees, and room and board, the borrower must provide written authorization. See Chapter 3 for more information.

Crediting funds to student account

A school that credits its students' accounts with Direct Loan funds must post those funds directly to the account for tuition and fees and room and board (if the student contracts with the school for room and board). As noted above, with the borrower's written authorization, the school may credit funds to the student's account for cost of attendance charges other than current tuition, fees, and room and board. A school that disburses Direct Loan funds by crediting the student's school account must use those funds for outstanding current and authorized charges before disbursing any funds directly to the student.

If a school applies SFA funds to a student account and determines that those funds exceed allowable charges, the school must pay the student or parent the excess within 14 days of one of the following events, whichever is **latest**:

- ◇ the date the balance occurs,
- ◇ the first day of classes of the enrollment period, or
- ◇ the date the borrower rescinds his or her authorization for the school to hold funds or use the excess funds to cover other expenses.

If a student's account shows a credit balance and a Direct PLUS Loan has been credited to the account, the school must distribute the excess PLUS funds to the parent borrower, unless the parent has provided written authorization allowing the school to give the funds to the student.

A school that offers courses of study by correspondence and that wishes to disburse Direct Loans must establish a lessons submission schedule and give that schedule to prospective students before they enroll. The course schedule must include

- ◇ a due date for each course lesson,
- ◇ if available, a description of any options for altering the sequence of lesson submissions,
- ◇ the course completion date, and
- ◇ the date that resident training must begin, its location, and the time frame for completing the resident training.

Schools must notify students or parents electronically or in writing when crediting the student's account with Direct Loan funds. Schools must send the notice **no earlier than 30 days before, and no later than 30 days after**, crediting the student's account. Schools must provide in the notice

- ◇ the date and amount of the disbursement,
- ◇ the borrower's right to cancel all or a portion of the loan or loan disbursement, and
- ◇ the procedures and time by which the borrower must notify the school that he or she wishes to cancel.

***Credit
balance paid
to student or
parent***

***Excess PLUS
funds***

***Correspondence
study***

***Disbursement
notification***

A school that sends the notice electronically must require the borrower to confirm receipt and must keep a copy of the confirmation. For example, if a school notifies a borrower through electronic mail, the school must request a “return receipt” message and keep a copy of the receipt on file.

**Disbursement
cancellation
notification**

Borrowers who wish to cancel all or a portion of a Direct Loan must notify the school. The school must honor the request if it is received no later than

- ◇ 14 days after the date the school sends the notice that it is crediting the borrower’s account, or
- ◇ the first day of the payment period, if the schools sends the notice more than 14 days before the first day of the payment period.

**Reporting
disbursement
information**

Schools must report required information on actual disbursements, disbursement cancellations, and disbursement adjustments—within 30 days after these occur—to the Loan Origination Center. For information on these procedures, including how to handle excess cash, see the *Direct Loan School Guide*. For information on the reconciliation process, see the *Reconciliation Guide for Direct Loans*.

**Returning
funds after
disbursement—
34 CFR
685.303(b)(3)**

If, after making a Direct Loan disbursement, a school determines that a student withdrew or was expelled before the first day of classes for the loan period or failed to attend school during that period, the school must return to the Department any loan proceeds credited to the student’s account within 30 days of the date established for the student’s withdrawal.¹ If the school disbursed loan proceeds directly to the student, the school also must return any payments the student made to the school, to the extent that no payments exceed the amount of loan proceeds the school disbursed to the student.

**34 CFR
685.211(d)**

If a school disbursed loan proceeds directly to a student who, without the school’s knowledge, provided false information or took actions to cause the borrower to be ineligible for the loan, the student must repay all or part of those proceeds, as appropriate.

¹To establish a student’s withdrawal date, schools must follow the procedures in Chapter 3. Note that for a student who does not return for the next scheduled term following a summer break, a school must determine the student’s withdrawal date no later than 30 days after the next scheduled term starts.

Counseling Borrowers

Schools participating in the Direct Loan Program are required by law to provide entrance and exit loan counseling. Exit counseling is for all student borrowers; entrance counseling is only for first-time student borrowers. A first-time borrower is someone who has not previously received a Direct Subsidized Loan, Direct Unsubsidized Loan, Federal Stafford Loan, Federal Unsubsidized Stafford Loan, or Federal SLS Loan. A school must maintain documentation in each student borrower's file substantiating the school's compliance with entrance and exit counseling regulations. Note that loan counseling requirements do not apply to parent borrowers.

This section offers an overview of counseling responsibilities. To help schools provide complete and effective counseling, the Direct Loan Program offers entrance and exit counseling guides for counselors and borrowers, plus companion videos. Schools receive annually an order form for these materials.

Entrance Counseling

Schools must conduct entrance counseling before making the first disbursement of a Direct Subsidized or Unsubsidized Loan, unless the student is enrolled in a correspondence program—or a study-abroad program—approved for credit at the home school. In these cases, the home school must mail the borrower written counseling materials before disbursing the loan proceeds.

Counseling may be conducted in person, by videotape presentation, or by computer-assisted technology. In each case, a person knowledgeable about SFA Programs must be available to answer borrowers' questions after the counseling session.

Although each school and each student's situation is different, the following suggestions may be useful for presenting entrance counseling's required information.

- ◇ **Schools must emphasize to students the seriousness and importance of the repayment obligation they are assuming.** Schools should advise students to read carefully the loan application, the disclosure statement, and the promissory note containing the borrowers' rights and responsibilities before signing any of these documents. Because a student loan is usually the borrower's first loan, schools should explain clearly

**Keeping
Direct Loan
Servicing
Center
informed**

the basic terminology to ensure that borrowers are fully aware of their obligations.

- ◇ Schools should mention that a borrower's **exact** repayment schedule will not be provided until loan repayment begins. Although the disclosure statement and the promissory note contain the loan's total dollar amount, including the interest rate and fees, these documents do not necessarily specify each payment amount or the payment frequency. Schools should remind students that certain fees will be subtracted from the loan amount **before** the loan is disbursed but that repayment of the **full** loan amount is required. Schools should emphasize that loan repayment is required even if the program is not completed or does not meet the borrower's expectations. This is a point at which schools could explain their refund policy, so that students know that if they leave school (for whatever reason), a portion of their loan disbursement **may** be returned to the Department.
- ◇ Schools also should explain to borrowers that they must inform their Direct Loan Servicing Center if they
 - fail to enroll in school for the period for which the loan was intended,
 - change schools,
 - change their name or address (including changing their permanent address while in school),
 - graduate or withdraw from school,
 - wish to apply for a deferment,
 - wish to request forbearance, or
 - are having difficulty repaying the loan.
- ◇ **Schools must describe in forceful terms the likely consequences of default, including adverse credit reports, wage garnishment, and litigation.** For information on default's effect on borrowers, see Section 4.
- ◇ **Schools must provide information about average indebtedness.** Schools are required to provide each borrower with general information about the average indebtedness of students who obtained Direct Subsidized or Direct

Unsubsidized Loans for attendance at the school or in a borrower's program of study.

- ◇ **Schools must inform the student about the average anticipated monthly repayment based on the average indebtedness.**

Borrowers should be told the financial aid office is there to help if they have questions about their Direct Loans. In addition, borrowers should be informed they also can get help by calling the Direct Loan Servicing Center.

Because many students leave school before the scheduled end of their academic programs, aid administrators should emphasize during entrance counseling that borrowers are obligated to attend exit counseling before they cease to be enrolled at least half time.

Schools may adopt alternative approaches for entrance counseling as part of the schools' quality assurance plans, described in section 685.300(b)(9) of the Direct Loan Program regulations. Schools adopting an alternative approach need not meet all the entrance counseling requirements described above, unless the Department determines that a school's approach is inadequate. Schools using an alternative approach must

- ◇ ensure that each first-time borrower is given written counseling materials containing the required information on the previous pages and in Direct Loan regulations;
- ◇ target those students most likely to default and provide them with more intensive counseling and support services; and
- ◇ include performance measures with objective outcomes demonstrating the alternative approach's effectiveness, such as levels of borrowing, default rates, and withdrawal rates.

Exit Counseling

Schools must conduct **in-person** exit counseling for Direct Subsidized or Direct Unsubsidized Loan borrowers shortly before they cease at-least-half-time study, **except**

- ◇ in the case of a correspondence program, schools must mail borrowers written counseling materials within 30 days after the borrowers complete the program; and
- ◇ if borrowers withdraw without a school's prior knowledge or fail to attend exit counseling sessions as scheduled, schools

Alternative approach

must mail written counseling materials to the borrowers' last known addresses within 30 days after learning the borrowers have withdrawn or failed to attend the scheduled session.

When sending exit counseling materials, return receipts are not required. However, schools should maintain documentation in borrowers' files verifying compliance with the regulatory counseling requirements. If borrowers fail to provide a name, address, references, or an employer and employer address, schools are not required to take further action.

Much of the same material presented at the entrance counseling session will be presented during exit counseling. For example, schools must inform borrowers about the seriousness and importance of their repayment obligation and describe in forceful terms the likely consequences of default (see Section 4). The emphasis for exit counseling shifts, however, to loan repayment obligations and debt management strategies. At the exit counseling session, the following points must also be covered:

- ◇ **Schools must inform borrowers of the average anticipated monthly repayment amount based on their indebtedness.** This information permits borrowers to begin short- and long-term financial planning.
- ◇ **Schools must review borrowers' available repayment options (the Standard Repayment, Extended Repayment, Graduated Repayment, and Income Contingent Repayment plans and loan consolidation).** Schools should explain that all Direct Loans must be repaid under the same repayment plan, except that borrowers with Direct PLUS Loans or Direct PLUS Consolidation Loans may repay those loans separately. Section 2 describes available repayment options; Section 3 covers loan consolidation.
- ◇ **Schools must provide debt management strategies that would facilitate repayment.** Schools should encourage borrowers to avoid excessive debt whenever possible. Borrowers should try to spend no more than 5 to 15% of their net income for monthly payments on student loans and consumer debts, including credit card and car payments. Borrowers using more than 15% of their monthly net income for these payments may need to make some budget adjustments.
- ◇ **Schools must explain to borrowers how to contact the Direct Loan Servicing Center.** The Direct Loan Servicing Center maintains toll-free telephone numbers and special mailing addresses to answer borrower inquiries. This information is in

the Direct Loan Program entrance and exit loan counseling guides; the phone numbers are also provided in Chapter 1 and on the inside front cover of this handbook.

- ◇ **Schools must review with borrowers deferment and discharge conditions.** Schools should inform borrowers that they can postpone loan payments by applying, and receiving approval, for a deferment or a forbearance through the Direct Loan Servicing Center. Section 2 describes deferments and forbearances.

- ◇ **Schools must require borrowers to correct school records concerning name, address, address of the borrower's next of kin, Social Security Number, references, driver's license number and the state where it was issued, and the name and address of the borrower's expected employer (if known).** Within 60 days after exit counseling, schools must provide the Direct Loan Servicing Center with any corrections to the name, latest known address, employer and employer address, and address of the borrower's next of kin. **(This latter item is a statutory requirement, although it is not yet in the regulations.)**

Verification

As is true for all schools participating in SFA Programs, Direct Loan schools must comply with verification requirements, explained in *The Verification Guide*. These requirements apply to Direct Subsidized Loan applicants but not to Direct Unsubsidized Loan or Direct PLUS Loan applicants.

Overawards

If a school becomes aware before Direct Loan funds are disbursed that a student has obtained additional financial assistance resulting in an overaward (that is, an award in excess of the amount for which the student is eligible), the school must take steps to eliminate the overaward. For example, the school may reduce the second or subsequent disbursement of the loan, or return excess loan proceeds to the Department. See Chapter 2 for a detailed discussion of overawards and a school's options.

Refunds

All schools must establish a fair and equitable refund policy for returning unused tuition, fees, and room and board charges connected with a

student who receives SFA funds but who has stopped attending school after attending at least one class. Schools must send all refunds directly to the Loan Origination Center—funds must not be given to students or parents. See Chapter 3 for a discussion of refunds.

Reconciliation

Schools participating in the Direct Loan Program create and transmit loan origination records and promissory notes, request and disburse funds, and report the maintenance and expenditure of those funds. A school's records of these activities are matched monthly to the records the Loan Origination Center maintains. Procedures for this monthly data match, called reconciliation, are covered in the *Direct Loan School Guide* and in the *Reconciliation Guide for Direct Loans*.

Student Status Confirmation Report Requirements

Schools are required to comply with Student Status Confirmation Report (SSCR) requirements. Schools complete and return these reports to the Department at least semiannually. The reports inform the Department of the address and enrollment status of students who borrowed Direct Subsidized and Direct Unsubsidized Loans and of students for whom parents borrowed Direct PLUS Loans. Schools must complete and return an SSCR to the Department within 30 days of receiving it.

Schools must report to the Department if the student

- ◇ has ceased to be enrolled on at least a half-time basis,
- ◇ was accepted for enrollment at the school but did not enroll on at least a half-time basis for the period for which the loan was intended or,
- ◇ has changed his or her permanent address.

If a school does not expect to submit an SSCR within 60 days of becoming aware that any of the above information has changed for any student, the school must inform the Department within 30 days of becoming aware of the change.

For complete information, see the *NSLDS Student Status Confirmation Report (SSCR) User's Guide*.

Schools that have successfully submitted SSCRs to NSLDS are exempt from the requirement to provide SSCRs directly to guaranty agencies. However, these schools must still respond to requests for borrower information from guaranty agencies, lenders, and loan servicing companies. Although the Department hopes to eventually eliminate the need for these requests, schools must continue to provide loan holders

and loan servicers with a borrower's enrollment status or enrollment history for deferment and other repayment purposes, or other information needed to locate a borrower, such as last known address, change in surname, and employer's name and address.

Recordkeeping and Audits

Chapter 3 contains complete information on recordkeeping and audit requirements. Highlights of those requirements are discussed here.

Schools must maintain records to document compliance with the statute and regulations. These records include but are not limited to

- ◇ the amount of the loan and the loan period for which the loan was intended,
- ◇ financial assistance that was available to the student and used in determining estimated financial assistance for the loan period,
- ◇ the data used to construct a student's budget or the school's itemized standard budget used in calculating the student's estimated cost of attendance,
- ◇ for Direct Subsidized Loans, the data used to determine the student's EFC,
- ◇ documentation of the student's eligibility to receive a Direct Loan,
- ◇ the amount and date of tuition and fees paid for the loan period,
- ◇ the amount of a refund paid to, or on behalf of, a student and the date and basis of the refund calculation,
- ◇ the date and amount of each loan disbursement,
- ◇ the student's job placement, if known,
- ◇ borrower information collected at the exit interview, and
- ◇ documentation that the student received both entrance and exit counseling.

Loan program records pertaining to borrower eligibility must be kept for three years after the end of the award year in which the student borrower last attended the school.

Other program records that are not borrower specific and that pertain to the school's participation in Direct Loans—including records such as the Program Participation Agreement and drawdown records that are not borrower specific—must be kept for three years after the end of the award year in which the school submits the records to the Department.

Each school may establish a fiscal and administrative recordkeeping system maintained in a variety of formats, for example, hard copy, microform, computer file, optical disk, or CD-ROM. In the event of a school's closure, termination, suspension, or change of ownership, the school or its successor must provide for the retention of records and for ready access to them by designated federal officials for auditing and examination purposes.

A school must cooperate in the conduct of audits, investigations, program reviews, or other reviews authorized by law. Cooperation includes providing timely access to records for Department and other authorized officials. Each year, an independent certified public accountant must audit the school; the audit must cover the period since the previous audit.

Any records involved in a federal audit procedure must be retained until the later of (1) the date the audit is completed or (2) the end of the record retention period.

In addition to Chapter 3, the Department's *Student Financial Assistance Programs Audit Guide* provides information.