

## CHAPTER 6

# RECEIVING AND DISBURSING FUNDS

### Essential Questions

- ❖ Do I need to maintain a separate bank account for Direct Loan funds? Do I need to maintain an interest-bearing account?
- ❖ What happens to the loan fees if the disbursement is canceled?
- ❖ What is excess cash?
- ❖ How do Option 2 schools receive Direct Loan funds?
- ❖ What is immediate need?
- ❖ Is there a Direct Loan authorization level?
- ❖ How does an Option 2 school receive Direct Loan funds?
- ❖ How should an Option 2 school decide when to request Direct Loan funds?
- ❖ How do Option 1 and Standard Origination schools receive funds?
- ❖ What is the timeline and disbursement process for Option 1 and Standard Origination schools?
- ❖ Do all Direct Loan schools control when students receive their funds?
- ❖ May schools disburse funds before receiving signed promissory notes?
- ❖ Does a school need a borrower's permission to credit that borrower's account with Direct Loan funds?
- ❖ What is the disbursement date?
- ❖ Can Direct PLUS Loans be applied to a student's account? If so, is parental authorization necessary?

### Essential Questions (continued)

- ❖ How can I decide how best to disburse funds?
- ❖ How do I report disbursements to the Direct Loan Servicing Center?
- ❖ How do I handle disbursement cancellations and adjustments? What about loan prepayments?
- ❖ What role does the Direct Loan Servicing Center play in the funds request process?

### General Information

- ❖ Option 2 schools calculate funding needs and make their own Direct Loan funding requests. (Direct Loan funding requests may not be combined with other Title IV funding requests.) For Option 2 schools, requesting funds does not depend on submitting loan origination records or promissory notes to the Direct Loan Servicing Center. Note, however, that until the Servicing Center accepts the records and notes, these schools are responsible for the funds the Department advances.
- ❖ Option 1 and Standard Origination schools receive funds management assistance from the Direct Loan Servicing Center. The Servicing Center calculates funding needs and requests funds based on anticipated disbursement information provided on accepted loan origination records and promissory notes.
- ❖ All schools must maintain a bank account for depositing funds, although the account normally need not be a separate Direct Loan account. A school must either notify the bank that the account contains federal funds and must keep a record of this notice in the school's recordkeeping system, *or* the school must ensure that the account's name includes the words "federal funds."

In addition, except for public institutions, schools must file a UCC-1 statement with their state or municipal governments disclosing that the bank account contains federal funds. Schools must keep a copy of the UCC-1.

If the school chooses to use, or is required to use, an interest-bearing account until the school disburses funds to students, any interest earned in excess of the \$250 annual allowance for administrative expense must be returned to the

Department at least annually. Interest earnings are returned per the Department's Payment Management System (EDPMS) instructions or instructions found in *The Blue Book*. Interest earnings do not have to, but may, appear on the EDPMS 272 report.

A school is *not* required to maintain an interest-bearing account if one of the following situations applies:

- In the prior award year, the school drew down less than \$3 million from Title IV programs.
  - The school earned less than \$250 in interest on the total amount of Title IV funds drawn down in the prior award year.
  - The school demonstrates by its cash management techniques that it would not earn over \$250 in interest by maintaining the total amount of Title IV funds drawn down during the award year in an interest-bearing account.
- ◆ Loan fees of 4 percent of the principal amount borrowed are charged the borrower to defray the cost of the Direct Loan Program. Drawdowns are based on net disbursements (disbursement less the loan fee on that disbursement).

If a disbursement is canceled within 120 days, loan fees are not owed. In such cases, the interest is "backed out" when the school or the borrower returns the funds. If the borrower sends back only part of the funds, the borrower must send a letter to the Direct Loan Servicing Center explaining that he or she is returning funds.

If a disbursement is canceled after 120 days, the fees must be paid. In this case, the school must determine whether the school or the borrower will pay and should consider developing a policy that ensures borrowers are treated fairly. (See page 6-15 for more on disbursement cancellations.)

If a disbursement is adjusted downward within 120 days, the fees are owed only on the portion of the disbursement the student receives.

- ◆ If a school receives too much in funds, or if funds are not disbursed as anticipated, the school must return the funds to the Department as excess cash. Generally, "excess" is defined as any funds not used within 3 business days of receipt. However, a school may hold such funds an additional 7 business days if the school meets the excess cash tolerance requirements in

section 668.166(b) of the regulations and if the school will disburse the excess funds within the additional 7 days.

- ◆ If an Option 2 school draws down insufficient funds and disburses, a deficit spending situation exists. The school should then draw down the amount of the deficit.

### Requesting Funds: Option 2 Schools

#### *Calculating Funding Needs*

If you are at an Option 2 school, you will estimate—on an ongoing basis—the amount of funds needed to make anticipated Direct Loan disbursements (net of loan fees). You include in your estimate Direct Subsidized, Direct Unsubsidized, and Direct PLUS Loans, and you consider Direct Loan funds on hand.

To make the estimate, you use the Direct Loan software or similar system. When a borrower's record is ready (that is, when you have created the loan origination record and obtained the completed, signed promissory note), the software "flags" the record as eligible for payment. You may increase or decrease the system-calculated amount of funds required based on historical anticipated need.

- ◆ Note that even if the anticipated disbursement date has passed for a particular borrower, the software will include the anticipated disbursement amount in any calculations that estimate the school's cash needs if
  - the record has not been included in a previous request
  - the record is flagged as eligible for payment
  - the parameters you set to select eligible records include the borrower's anticipated disbursement date

#### *Timing the Requests for Direct Loan Funds*

You request funds based on "immediate need," which the Department defines as the amount of funds you will need for your borrowers within a three-day period. In other words, you must spend funds as soon as administratively feasible but no later than three business days following the date you received the funds using either Automated Clearing House/Electronic Funds Transfer (ACH/EFT) or FEDWIRE.

Immediate need differs among schools; however, you should consider these basic factors in formulating a request for funds:

- ❖ the balance of Direct Loan cash on hand
- ❖ anticipated disbursements
- ❖ anticipated fund recoveries

By determining when cash is needed, you can predict when to initiate the request.

The following chart displays approximate timelines for receipt of funds for schools using the ACH/EFT method. To distinguish between morning and afternoon, the daily cutoff is 3:30 p.m. Eastern time.

<b>Timeline For Requesting/Receiving Direct Loan Funds Using ACH/EFT</b>	
<b>Funds Requested</b>	<b>Funds Received</b>
Monday morning Monday afternoon/Tuesday morning Tuesday afternoon/Wednesday morning Wednesday afternoon/Thursday morning Thursday afternoon/Friday morning Friday afternoon/Monday morning	Wednesday or Thursday Thursday or Friday Friday or Monday Monday or Tuesday Tuesday or Wednesday Wednesday or Thursday

*Requesting Direct Loan Funds*

Option 2 schools are authorized to draw down funds directly from EDPMS. **Unlike some other financial aid programs, there is no Direct Loan authorization level.**

Once your immediate cash needs have been determined, the following steps must occur:

- ❖ You transmit an electronic payment request for Direct Loan funds only, using
  - the telephone—by speaking with a service bureau representative or by using the touch tone telephone keys to enter the request
  - the FEDWIRE software if you receive funds via FEDWIRE
  - the Direct Loan software

(Note that security levels in the Direct Loan software allow your school the flexibility to authorize certain personnel to make funding requests but not to perform other types of functions, such as loan origination or importing/exporting records.)

- ❖ The EDPMS service bureau processes your drawdown request.
- ❖ The service bureau checks that the account type, PIN number, and password identifiers are valid.
  - If any identifiers are invalid, you are notified to correct the error.
  - Valid requests are batched and sent daily to EDPMS for further processing.
- ❖ Drawdown requests are edited and batched, and an ACH/EFT payment file is created for transmittal to the Federal Reserve Bank (FRB).
  - Problem requests are transferred to a holding file. Department personnel review the holding file daily and either approve the transaction or contact your school to resolve the problem.
- ❖ The FRB receives the ACH/EFT file and transfers funds to your school's bank account.
- ❖ As mentioned earlier, Direct Loan funds may be deposited in the same account with other funds, although you must be able to identify Direct Loan funds.
- ❖ The FRB notifies the Department if an ACH/EFT transmission or your school's transaction is rejected.
  - ACH/EFT transmissions may be rejected because of mechanical difficulties or because your school's designated bank account has changed. If the ACH/EFT transmission is rejected, the Department contacts your school to resolve the problem.
- ❖ Your school's bank should receive funds within 48 to 72 hours after you transmit the drawdown request, depending on the time of day you sent the request.

### *Issues to Consider in Requesting Funds*

- ❖ To determine when it is appropriate to draw down funds, you may want to consider first whether you will disburse before or after federal funds are received. In other words, is your campus willing to allow you to disburse funds to students before federal funds are received? This is a situation that may put an account “in the red,” also known as deficit spending. Consider the following possibilities:
  - If you disburse before receiving federal funds, your disbursement date will be earlier than the date federal funds are received. The disbursement date is still the date you pay the student or credit the account—whether or not you do so with federal funds.
  - If you disburse after receiving federal funds, you are saying you do not accept deficit spending. Funds will be disbursed only after they are received; therefore, your disbursement date is the date federal funds are transferred to the student’s account.
- ❖ To determine when you will draw down funds, establish your disbursement date first. In doing so, remember the disbursement requirements.
- ❖ There may be a number of other important dates to consider, including
  - your bill due date(s)
  - the date your bills are mailed
  - the end of your drop/add period
- ❖ Remember that interest accrues on the funds you request until you spend them, so spend quickly. If your school maintains Title IV funds in an interest-bearing or investment account, and the interest earned before you spend your funds exceeds the \$250 annual allowance for administrative expense, you must return the excess to the Department as explained on page 6-2.
- ❖ Assess the time it takes you to draw down funds and spend them within three days. Evaluate the results and determine if adjustments are needed.
- ❖ Chart the amounts you are drawing down and spending, especially during the beginning of your term. This will help you project future cash needs.

- ❖ Calculate your need for funds and export that data to the EDPMS Service Bureau early enough to meet the 3:30 P.M. cutoff.
- ❖ If you use the Direct Loan software to calculate your drawdown request, consider that the amount you request will be based on all loan origination records with a certain anticipated disbursement date. You have the option to manually override this amount and increase or decrease it.
  - You might increase the amount requested because you know you will receive more signed promissory notes before your funds are received. You will want to be conservative when increasing the amount requested so you do not create an excess cash problem.
  - You might decrease the amount requested, especially if you know from experience that not all your students will maintain eligibility for their loans at the time of disbursement.
  - You have additional considerations when manually overriding the software's drawdown request. If you adjust the amount downward, the software does not know which students were excluded; it records all loans with a specific anticipated disbursement as included in that drawdown request and will not add them to future drawdown calculations. If you intend to disburse some of these loans at a later date, you will need to include them by subsequent manual override(s).
- ❖ Monitor excess cash daily.
- ❖ You may want to evaluate and assess the current process of funds drawdown on your campus. You now have software available that can determine the amount of funds you need. Given that, should the drawdown be conducted by the financial aid office? By your accounting department? By contracts and grants? By your bursar? By other offices?
- ❖ Remember that the regulations require that the functions of authorizing payments and disbursing funds be kept separate, so that no one office has responsibility for both.
  - Reexamine how information flows between the financial aid, bursar, and business offices. With the increased volume of Direct Loans funds, the cash management regulations, and the need to meet strict time requirements in drawdowns and excess cash calculations, the process at your school may need to be streamlined and reengineered.

- If Direct Loan funds are to be drawn down by an office other than the financial aid office, remember to set up your Direct Loan security access accordingly. (See the description of software security levels in Chapter 2.)

### **Requesting Funds: Option 1 and Standard Origination Schools**

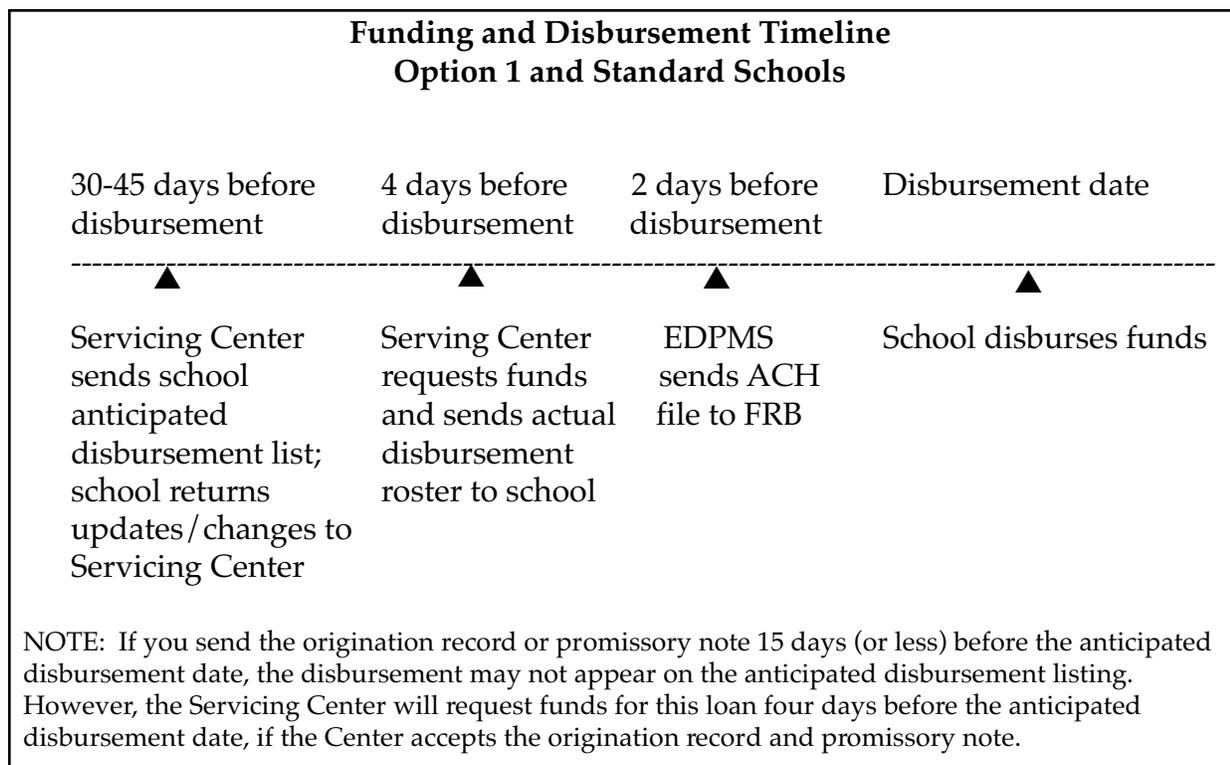
These schools follow different procedures to receive Direct Loan funds. The Direct Loan Servicing Center initiates the schools' funding requests based on these schools' loan records and promissory notes.

If you are an Option 1 or a Standard Origination school, your procedures are as follows:

- ❖ You send a loan origination record to the Direct Loan Servicing Center, which must accept (approve) the records.
- ❖ If you are an Option 1 school, once you and your students have completed the appropriate portions of the promissory notes, you mail them to the Servicing Center, which must accept the notes before funds may be drawn down. If you are a Standard Origination school, your borrowers return the notes to the Servicing Center.
- ❖ Approximately 30 to 45 days before the anticipated disbursement dates in the loan origination record, the Direct Loan Servicing Center will send an electronic anticipated disbursement list advising you of anticipated disbursements by borrower and loan type.
- ❖ You review the list to determine whether updates or adjustments need to be made, particularly to the disbursement amounts and anticipated disbursement dates.
- ❖ You send any necessary change records to the Direct Loan Servicing Center.
- ❖ The Direct Loan Servicing Center will request funds for your school based on the anticipated disbursement dates you provide and based on the amounts on the loan origination records, including any changes. You can control the frequency and timing of receiving drawdowns by means of the anticipated disbursement dates.
- ❖ The Servicing Center requests funds four days before the anticipated disbursement dates.

- ◆ The Servicing Center will simultaneously create and send an actual disbursement roster to you that reflects individual borrowers, loan types and their associated actual disbursements, and the total amount of funds in the request.
- ◆ The funds will be sent to your school’s bank through the Automated Clearinghouse (ACH) and should be received on or near the anticipated disbursement date.

The timeline below illustrates the funding and disbursement process for Option 1 and Standard Origination schools.



### **Disbursing Funds to Borrowers**

All Direct Loan schools control—within the limits of the regulations—*when* students receive their funds, just as schools now do under the Federal Pell Grant and federal campus-based programs.

The following steps must be taken to disburse funds:

- ◆ The school establishes disbursement dates, taking into account the requirements concerning the number, amount, and timing of the disbursements.

- The earliest a student account may be credited or a student may be paid by cash or check is 10 days before the first day of the enrollment period.
  - Remember that there is a 30-day delay for disbursing loans to first-year undergraduate students who have not previously received an FFEL or Direct Loan. Note that this delay does not apply to a Direct PLUS Loan borrower whose child is in the first year of his or her program.
  - In most cases, multiple disbursements (a minimum of two) are required, even for partial academic year attendance. This requirement does not apply to experimental schools, however.
  - Generally, no disbursement can be greater than 50 percent of the loan amount. (Again, this requirement does not apply to experimental schools.) Note, however, that if one-half of the loan period has elapsed when the first disbursement is made, the loan may be disbursed in a single installment.
- ❖ As is required for schools under the FFEL Program, schools must verify that their students maintain eligibility for Direct Loans.
  - ❖ The school (or the Direct Loan Servicing Center for Standard Origination schools) must have a signed, completed promissory note from the borrower before disbursement.
  - ❖ Other than the information provided in the promissory note, the school is not required to notify the borrower of any anticipated disbursement. However, if the school credits funds to the student's account, the school must notify the student or parent borrower in writing (for example, through the monthly statement) or by equivalent electronic means. A school notifying a student or parent electronically must request a confirmation of the notice's receipt and must maintain a record of that confirmation. No notification is required if the school pays all funds to the borrower by check or cash.
  - ❖ The school may apply Direct Loan proceeds to the student's account without written authorization separate from the promissory note and without acknowledgment from the borrower.
    - In fact, if a school has a student accounts receivable system, the law *requires* that the loan funds be posted directly to a borrower's account for tuition and fees and room and board (if the borrower contracts with the school for room and board).

- ◆ With the student's authorization, the school may also credit funds to the student's account for other Cost of Attendance charges the student owes and for other institutional charges the student incurs at his or her discretion. If the student's account shows a balance remaining, a check or similar instrument requiring the borrower's endorsement must be issued to the borrower within 14 days or 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 to use the excess funds to cover other expenses or to hold excess funds. (The student can also be paid in cash.)

Schools unaccustomed to issuing checks may wish to issue a check or similar instrument that includes all Title IV program proceeds not needed for institutional charges.

The disbursement date (the date funds are paid to the borrower) is the earliest of

- ◆ the date funds are credited to the student's account (whether the initial funds are federal or institutional)
- ◆ the date the check (or cash) is made available to the borrower
- ◆ the date an electronic funds transfer is made to a bank account designated by a student or parent borrower

Keep in mind that for Option 2 schools, funds drawn down are not borrower specific and may be disbursed to any eligible borrower. Option 1 and Standard Origination schools may disburse funds only to the borrower for whom they were drawn down.

### *Special Direct PLUS Loan Considerations*

Schools that credit student accounts directly are encouraged to post Direct PLUS Loan funds to a student's account for tuition and fees and room and board (if the student contracts with the school for room and board). With the parent borrower's authorization, funds also may be credited to the student's account for other Cost of Attendance charges the student owes the school and for other institutional charges the student incurs at his or her discretion.

- ◆ Schools might consider notifying parents when the student's account is credited. If one of the parents dies, the surviving parent can notify the school so that no further disbursements will be credited to a student's account.

If the student's account shows a balance remaining, the school must either issue a check to the parent borrower or obtain authorization from the parent borrower to issue a check or similar instrument of endorsement to the student.

Consider the following options:

- ❖ Obtain parental authorization at the time the Direct PLUS application/promissory note is received, allowing you to give excess funds to the student.
- ❖ Include the Direct PLUS Loan authorization into your school's institutional application (completing the authorization would, of course, be optional).
- ❖ Modify your student accounts receivable system to allow you to create and mail Direct PLUS Loan checks to the parent for the amount that exceeds institutional charges.

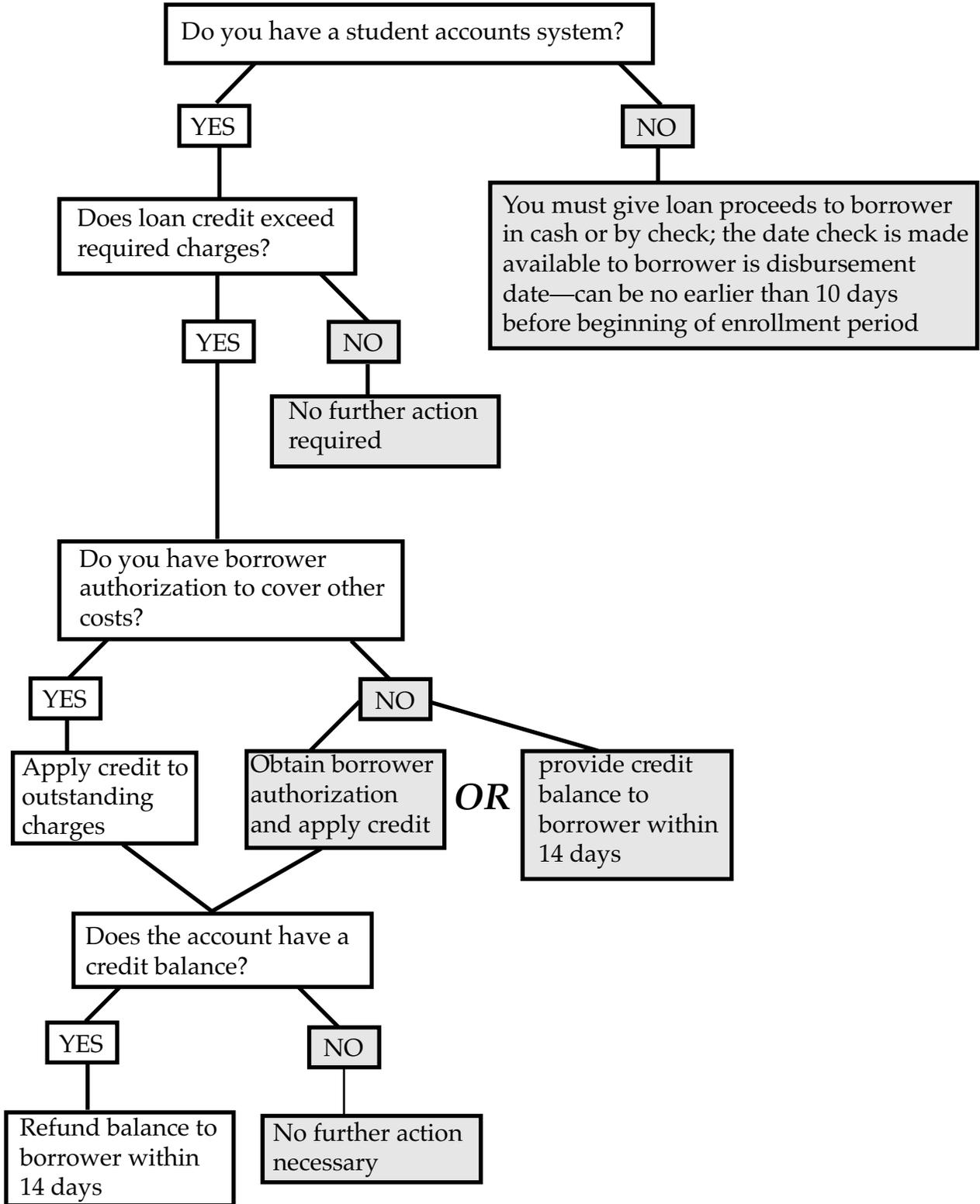
If there is a credit balance, schools that disburse funds in a specific order will be able to determine which funds produced the credit balance.

- ❖ For example, a school may first apply Direct PLUS Loan funds to a student's account and then apply other types of financial aid funds. If the student's charges exceeded the Direct PLUS Loan amount, any resulting credit balance after applying other financial aid would not be attributed to the Direct PLUS Loan, making a parent authorization unnecessary.
- ❖ Applying Direct PLUS Loan funds to the student account first may minimize the number of Direct PLUS Loan credit balance checks you will have to create. To accommodate this situation, it may be necessary to delay the disbursement of other aid.

### *Informing Students About Disbursements*

Student money management and budgeting behavior may change as a result of Direct Loans being applied to the student account. Some students have been accustomed to using their student loan check for start-up costs until other funds are available, which may have resulted in a later payment of school charges. When the Direct Loan is applied to their accounts, students may need to plan differently for how they will cover their education-related expenses. You may wish to prepare your students for this change before school starts by including information on the Direct Loan disbursement process at your institution and offering other funding alternatives to students (such as interest-free loans). The chart on the next page may help clarify the disbursement process.

DISBURSEMENT DECISION CHART



## Reporting Disbursements

After disbursing funds, schools must report the required information about actual disbursements to the Department's Direct Loan Servicing Center. Schools must transmit disbursement records to the Direct Loan Servicing Center as soon as possible but no later than 30 days after disbursement.

- ❖ Option 2 schools record the actual disbursement date and amount of each disbursement using the Direct Loan software the Department provides or another system the school maintains.
- ❖ As noted earlier, Option 1 and Standard Origination schools will receive a disbursement roster from the Direct Loan Servicing Center indicating the borrower, loan type, and amount to be disbursed. These schools must verify or correct the disbursement amount for each borrower, record the date and amount of each disbursement using the Direct Loan software or another system the school maintains, and electronically transmit actual disbursement records to the Servicing Center.

## Payment Adjustments

**Disbursement cancellations** occur when, within 120 days of the disbursement date

- ❖ the school determines the disbursement should not have been made
- ❖ the borrower does not accept any of the disbursement (note that if funds are credited electronically, schools are not required to cancel the loan if the student does not pay the outstanding balance through other means)
- ❖ the borrower or the school returns all the funds
- ❖ a Title IV refund occurs that causes a refund of the total amount disbursed

**Adjustments** occur when, within 120 days of the disbursement date

- ❖ a borrower's eligibility changes (note that if circumstances change after a loan has been **entirely** disbursed—for example, additional aid comes in—no adjustment is necessary)
- ❖ a borrower or a school returns a portion of the disbursement

- ◆ a mistake is made on the amount disbursed
- ◆ there is a Title IV refund that is less than the full amount disbursed

A **prepayment** is any loan payment made to the Servicing Center before the payment is due and at least 121 days after the disbursement date. Borrowers can prepay at *any* time, including after they enter repayment. Borrowers normally make prepayments, but the school may transmit funds if it wishes to pay on their behalf.

The chart on the next page summarizes these provisions.

## Direct Loan Cancellations, Adjustments, and Payments

### Disbursement Cancellations\*

A disbursement cancellation occurs when the borrower or the school returns the total disbursement amount the borrower receives within 120 days of the disbursement date. Events that would cause a *disbursement cancellation* include the following:

- ◆ The school determines the disbursement should not have been made.
- ◆ The borrower does not accept any of the disbursement.
- ◆ The school returns the funds, or the borrower returns to the school all funds that have been disbursed.
- ◆ A Title IV refund is due, which would cause a refund of the total amount disbursed.

An Option 2 school returns canceled funds to its “federal” bank account when the school has determined or has knowledge that one of the events listed above has happened. An Option 1 or Standard Origination school returns the canceled funds to the Servicing Center. All schools send disbursement and cancellation records to the Direct Loan Servicing Center. **The borrower is not responsible for the loan fees and accrued interest for a canceled disbursement.**

### Disbursement Adjustment\*

A disbursement adjustment is the return of a portion of the amount of a disbursement within 120 days of the disbursement date. Events that would cause an *adjustment* include the following:

- ◆ A disbursement amount was input incorrectly and must be corrected.
- ◆ A reduction in the amount of the student’s eligibility results in a downward adjustment to a disbursement.
- ◆ A refund due (under the Title IV refund policy) is less than the full amount of the disbursement.

Other than to correct a data error, if an Option 2 school adjusts a disbursement downward, it returns the net adjustment amount (the amount the borrower returns) to the “federal” bank account. An Option 1 or Standard Origination school returns the net adjustment amount to the Servicing Center. All schools send disbursement adjustment records reflecting the adjustment to the Servicing Center. **The borrower is responsible for loan fees and accrued interest only on the total adjusted amount of the disbursement.**

### Payment of a Loan Balance\*\*

A partial or total disbursement returned, either by the school or the borrower, 121 days or more after the date of the disbursement does not reduce the loan amount borrowed. Rather, the payment is applied to the borrower’s account just like any regular payment. If a payment must be made, the school or borrower must send a check to the Servicing Center with the appropriate information needed to apply the amount to the borrower’s account. After receiving the check, the Servicing Center will apply the payment amount to late charges, collection costs, and outstanding interest before crediting it to the principal balance. **The borrower is responsible for the loan fees and any accrued interest on the original amount of the loan.**

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\* within 120 days of the disbursement date

\*\* after the 120-day cancellation/adjustment period

## **Direct Loan Servicing Center Response and Actions**

- ◆ The Direct Loan Servicing Center receives and processes the disbursement records schools send. Each disbursement record is matched to a borrower/loan record and edited against other data such as loan amount and borrower status. Electronic disbursement records are edited and validated within one business day.
  - If the disbursement record passes the edits, the borrower/loan record is updated, and the loan is “booked,” provided the Direct Loan Servicing Center has accepted the loan origination record and promissory note.
  - If there is a problem with the disbursement record, the Direct Loan Servicing Center notifies the school (via the acknowledgment record) to resolve the problem.
- ◆ After the loan is “booked,” the Servicing Center produces a letter within 10 business days to notify the borrower of the disbursement and to redisclose the terms of the loan. The borrower is given a contact and a toll-free number to discuss the loan. After the borrower receives this notification, he or she contacts the Servicing Center directly with any questions or concerns.
- ◆ The Direct Loan Servicing Center matches second and subsequent disbursements against the borrower’s specific loan record, previously established in its data base.

For more information on Servicing Center (and origination) functions and response times, see Chapter 9, page 9-9.