

Enactment of the Higher Education Reconciliation Act of 2005 Loan Issues

(Enclosure to DCL GEN-06-02 and FP-06-01)

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TOPICS PRIMARILY AFFECTING INSTITUTIONS AND BORROWERS

Consolidation loans

**§428(b)(7)(A)
§428C(a)(3) and (b)(5)
§455(a), (d), and (g)**

In-school and early conversion to repayment consolidation

The HERA eliminated the provision in section 428(b)(7)(A) that allowed a FFEL borrower who is enrolled in school on at least a half-time basis to request to enter repayment early on his or her Stafford Loans if the lender approves. Repayment is now defined as not beginning until 6 months and one day after the date the student ceases to carry at least one-half the normal full-time academic workload, as determined by the school. A change to section 428C(a)(3) clarifies that repayment status for FFEL Consolidation Loan eligibility incorporates this revised definition of the repayment period. Therefore, a FFEL borrower who is still enrolled in school at least half-time may no longer request to enter repayment early to apply for a FFEL or Direct Loan Consolidation Loan.

The HERA also amended section 455(a) to provide that Direct Consolidation Loans shall have the same terms, conditions, and benefits as FFEL Consolidation Loans, except as otherwise provided in the HEA. In addition, section 455(g) was amended to define an eligible borrower for a Direct Consolidation Loan as one who meets the definition of that term in the FFEL Consolidation Loan program. These changes eliminate Direct Loan In-School Consolidation.

The changes to section 428(b)(7)(A) apply to borrower requests received by FFEL lenders on or after July 1, 2006. The changes made to section 455(a), apply to Consolidation Loan applications received by the Direct Loan Program on or after July 1, 2006. The changes clarifying the definition of repayment for FFEL Consolidation Loans in section 428C(a)(3) and defining eligible borrower for Direct Consolidation Loans in section 455(g) are effective for Consolidation Loan applications received on or after July 1, 2006.

Direct Consolidation Loan repayment plans

The HERA requires that the repayment plans offered in the Direct Loan program must generally be the same as those offered in the FFEL program under section 428(b)(9). The Direct Loan Program, however, will still offer income contingent repayment plans, which are not the same as the income-sensitive repayment plans offered in the FFEL Program. This change also applies to Direct Consolidation Loans. As a result, the following changes are made to the repayment plans offered to Direct Consolidation Loan

borrowers, *effective for Direct Consolidation Loan applications received on or after July 1, 2006:*

1. A graduated repayment plan must be paid over a fixed period, not to exceed 10 years, regardless of the loan amount, and
2. An extended repayment plan is available only to a borrower with a total outstanding balance being consolidated of more than \$30,000, who borrowed for the first time on or after October 7, 1998, and may not exceed 25 years of fixed annual or graduated repayment amounts.

Section 455(d)(1) authorizes the Secretary to offer Direct Loan program borrowers a variety of repayment plans under criteria established by the Secretary. Under this authority, the Department will also allow Direct Consolidation Loan borrowers who consolidate loans in excess of \$30,000 to elect a repayment schedule consistent with that offered to FFEL Consolidation borrowers under section 428C(c)(2). *This option is available for borrowers whose Direct Consolidation Loan applications are received on or after July 1, 2006.*

Termination of eligibility for FFEL and Direct Consolidation Loans

The changes made to section 428C(a)(3)(B) by the HERA provide that a Consolidation Loan borrower loses eligibility to borrow a FFEL or Direct Consolidation Loan after receiving a consolidation loan, except that:

1. A borrower who receives additional eligible loans after the receipt of the consolidation loan may receive a subsequent consolidation loan;
2. Eligible loans received before or after the consolidation loan was received may be added to the existing consolidation loan during the 180-day period following receipt of that consolidation loan;
3. Eligible loans received prior to the date of the first consolidation loan may be added to a subsequent consolidation loan; and
4. A FFEL Consolidation Loan borrower may obtain a subsequent consolidation loan under the Direct Consolidation Loan program for the purpose of securing an income-contingent repayment schedule if the FFEL lender has requested default aversion assistance from the guaranty agency.

These changes are effective for Consolidation Loan applications received on or after July 1, 2006.

Joint Consolidation Loans

The changes made to section 428C(a)(3)(C) by the HERA eliminate the ability of a married couple to consolidate their eligible student loans in a joint FFEL or Direct Consolidation Loan. *This change is effective for Consolidation Loan applications received on or after July 1, 2006.*

FFEL borrower access to the Direct Consolidation Program

The changes made to section 428C(b)(5) by the HERA permit FFEL borrowers who do not also have Direct Loans to apply for a Direct Consolidation Loan only if a FFEL Consolidation lender denies the eligible borrower's FFEL Consolidation Loan application or denies an application for a consolidation loan requesting income-sensitive repayment terms, or if the borrower has defaulted and the Consolidation Loan will resolve the default. *This change is effective for Direct Consolidation Loan applications received on or after July 1, 2006.*

Direct Loan repayment plans

§455(d)(1)

The HERA requires that the repayment schedules offered in the Direct Loan program must generally be the same as those offered in the FFEL program under section 428(b)(9). However, the Direct Loan program will continue to offer income contingent repayment plans, and the FFEL program will offer different income-sensitive repayment plans. In addition to an income contingent repayment plan, *the following repayment plans will be available to Direct Loan borrowers who enter repayment on their loans on or after July 1, 2006:*

- A standard repayment plan, with a fixed annual repayment amount paid over a fixed period of time, not to exceed 10 years;
- A graduated repayment plan paid over a fixed period of time, not to exceed 10 years; and
- For new borrowers on or after October 7, 1998, with \$30,000 in outstanding loans accumulated on or after that date, an extended repayment plan, with a fixed annual or graduated repayment amount paid over a period not to exceed 25 years.

The Secretary also is authorized by section 455(d)(4) to provide, on a case-by-case basis, alternative repayment plans to a borrower who demonstrates that other available repayment plans are not adequate to accommodate the borrower's exceptional circumstances.

Disbursement of loans

§428(b)(1)(N)

§428G(e)

Eligible foreign institutions

The HERA amended section 428(b)(1)(N) to provide that for students studying outside the United States in a program of study at an eligible foreign institution, loans may be disbursed directly to the borrower only if the institution requests this method. The HERA further specifies that a lender or guaranty agency may honor the institution's request for a direct disbursement to the borrower only after verifying the borrower's enrollment at the institution, which is consistent with current guaranty agency program requirements discussed in DCL G-03-348, August 2003. "Enrollment" for this purpose means admission to the eligible foreign institution for new students, or a status that meets the definition of "enrolled" in 34 CFR 668.2 for continuing students. Without a request from

the institution, lenders must disburse loans directly to an office of the foreign institution designated by the institution to receive them. *This change is effective for loans first disbursed on or after July 1, 2006.*

Eligible foreign institutions are also no longer exempt from the multiple disbursement requirements of section 428G. These requirements include providing the lender with a disbursement schedule that provides for disbursement of the loan in multiple, substantially equal installments and delaying delivery of the first disbursement of a loan to a first-time, undergraduate borrower until the borrower completes 30 days of the program of study. *This change is effective for loans with loan periods beginning on or after July 1, 2006.* Eligible foreign institutions are eligible for the low cohort default rate exemptions.

Study-Abroad Programs

§428(b)(1)(N)

A student enrolled in a study-abroad program that is approved for credit by the student's home institution may request direct disbursement of his or her loan by the lender. Unlike the requirements governing direct disbursements to borrowers for attendance at eligible foreign institutions, the home institution is not required to request or approve the direct disbursement. However, as a result of the HERA, the lender or guaranty agency must verify a student's enrollment in the study-abroad program, as described for students attending eligible foreign institutions, before making a direct disbursement to the borrower. Direct Loan funds are disbursed to the borrower directly by the institution. Therefore, these provisions do not apply to the Direct Loan program. *This provision is effective for loans first disbursed on or after July 1, 2006.*

Low cohort default rate exemptions

§428G(a)(3) and (b)(1)

The exemption of institutions with low cohort default rates from certain multiple disbursement requirements has been reinstated in the law. An institution with a cohort default rate of less than 10 percent for each of the three most recent fiscal years for which data are available, including an eligible foreign institution, may once again disburse, in a single installment, loans that are made for one semester, one trimester, one quarter, or a four-month period. Such an institution is also no longer required to delay the delivery or disbursement of the first disbursement of a loan for 30 days for first-time, first-year undergraduate borrowers. *These changes are effective for any disbursement made on or after February 8, 2006.*

False certification discharges

§437(c)(1)

Effective July 1, 2006, a new type of false certification discharge has been created by the HERA, authorizing a discharge if the borrower's loan was falsely certified as a result of a crime of identity theft. Until the discharge regulations can be developed, lenders may provide administrative forbearance, and guaranty agencies may suspend default collections, if a borrower presents evidence, on or after July 1, 2006, that the lender or guaranty agency believes to be reasonably persuasive, showing that the borrower's loan may have been falsely certified as a result of a crime of identity theft.

Interest rates

§427A(1)(2)

The interest rate scheduled to take effect for Federal PLUS loans made under the FFEL Program increases from 7.9 percent to 8.5 percent on loans *for which the first disbursement is made on or after July 1, 2006*. The HERA did not make changes to the fixed 7.9 percent interest rate scheduled to take effect for Federal Direct PLUS loans first disbursed on or after July 1, 2006.

The HERA also did not change the provision in section 427A(1) that requires a 6.8 percent fixed interest rate *for all Stafford loans first disbursed on or after July 1, 2006 in both the FFEL and Direct Loan Programs*. This change from a variable to a fixed interest rate for Stafford Loans was enacted as part of earlier legislation, and does not affect a borrower's variable interest rate on loans made before July 1, 2006.

Loan limits

§425(a)(1)(A)

§428(b)(1)(A)

§428H(d)

Some (but not all) of the annual loan limits in the Stafford Loan Program have been increased, as shown in the chart below, *effective July 1, 2007*. Increases for first and second year undergraduate students were also made to section 425(a)(1)(A) for the inactive Federal Insured Student Loan (FISL) Program.

For undergraduate students, the first year subsidized/unsubsidized combined annual loan limit has been increased from \$2,625 to \$3,500, and the second year subsidized/unsubsidized combined annual loan limit has been increased from \$3,500 to \$4,500. The combined annual loan limits were not increased for borrowers beyond the first two years of undergraduate study. For graduate or professional students, the additional unsubsidized annual loan limit has been increased from \$10,000 to \$12,000.

For students who have obtained a baccalaureate degree and are enrolled in coursework necessary for enrollment in a graduate or professional program, the additional unsubsidized loan limit has been increased from \$5,000 to \$7,000. The subsidized/unsubsidized combined loan limit has not been increased for these students.

The subsidized/unsubsidized combined loan limit and the additional unsubsidized loan limit for a student, who is enrolled in coursework necessary for enrollment in an undergraduate program, have not been increased, and remain at \$2,625 and \$4,000.

For students who have obtained a baccalaureate degree, and are enrolled in coursework necessary for a professional credential or certification from a state required for employment as a teacher in an elementary or secondary school, the additional unsubsidized loan limit has been increased from \$5,000 to \$7,000. The subsidized/unsubsidized combined loan limit has not been increased for these students.

Effective date: The increased loan limits resulting from the HERA are shown below in bold italics and are effective for any loan certified or originated on or after July 1, 2007:

| | Base Sub/Unsub | Additional Unsub |
|---------------------------------|-----------------------|------------------------|
| 1st year undergraduate | <i>\$3,500</i> | \$4,000 |
| 2nd year undergraduate | <i>\$4,500</i> | \$4,000 |
| 3rd year & beyond undergraduate | \$5,500 | \$5,000 |
| Graduate/professional | \$8,500 | <i>\$12,000</i> |

| | | |
|---|---------|-----------------------|
| Preparatory coursework (for enrollment in an undergraduate program) | \$2,625 | \$4,000 |
| Preparatory coursework (for enrollment in a graduate or professional program) | \$5,500 | <i>\$7,000</i> |

| | | |
|-----------------------|---------|-----------------------|
| Teacher certification | \$5,500 | <i>\$7,000</i> |
|-----------------------|---------|-----------------------|

Military deferment

§428(b)(1)(M)
§455(f)(2)(C)
§464(c)(2)(A)
§481(d)

Effective July 1, 2006, for all three loan programs (FFEL, Direct Loans, Perkins Loans), a new military deferment has been created, effective for loans for which the first disbursement is made on or after *July 1, 2001*. On or after July 1, 2006, a qualified borrower may receive a deferment for a period in which he or she meets the qualifications after July 1, 2001. The deferment shall not exceed a total of three years, and applies only to periods during which borrowers are serving on active duty during a war or other military operation, or national emergency, or performing qualifying National Guard duty during a war or other military operation or national emergency. As a result, not all active duty military personnel are eligible for this new deferment. The HERA

does not authorize the refunding of any loan repayment already made by a borrower at the time the deferment is granted.

In some cases, a borrower may be eligible for a military deferment on loans first disbursed on or after July 1, 2001, but ineligible for the deferment on older loans. A borrower consolidating loans first disbursed on or after July 1, 2001, is eligible for the new deferment on the entire Consolidation Loan, but only if all of the borrower's Title IV loans included in the Consolidation Loan were first disbursed on or after July 1, 2001.

For purposes of this new deferment, the following terms are defined in new section 481(d):

- *Active duty* has the meaning for that term included in section 101(d)(1) of title 10, United States Code, but does not include active duty for training or attendance at a service school.
- *Military operation* means a contingency operation as defined in section 101(a)(13) of title 10, United States Code.
- *National emergency* means the national emergency by reason of certain terrorist attacks declared by the President on September 14, 2001, or subsequent national emergencies declared by the President by reason of terrorist attacks.
- *Serving on active duty during a war or other military operation or national emergency* means service by an individual who is a Reserve of an Armed Force ordered to active duty under section 12301(a), 12301(g), 12302, 12304, or 12306 of title 10, United States Code, or any retired member of an Armed Force ordered to active duty under section 688 of such title, for service in connection with a war or other military operation or national emergency, regardless of the location at which such active duty service is performed. This term also includes any other member of an Armed Force on active duty in connection with such emergency or subsequent actions or conditions who has been assigned to a duty station at a location other than the location at which such member is normally assigned.
- *Qualifying National Guard duty during a war or other military operation or national emergency* means service as a member of the National Guard on full-time National Guard duty (as defined in section 101(d)(5) of title 10, United States Code) under a call to active service authorized by the President or the Secretary of Defense for a period of more than 30 consecutive days under section 502(f) of title 32, United States Code, in connection with a war, other military operation, or a national emergency declared by the President and supported by Federal funds.

Documentation establishing eligible active duty service for the new deferment may include a copy of the borrower's military orders, or a written statement from the borrower's commanding officer or personnel officer that the borrower is serving on active duty during a war or other military operation, or national emergency, or performing qualifying National Guard duty during a war or other military operation or national emergency, as those terms are defined above.

PLUS loans for graduate or professional students

§428B

As a result of the HERA, graduate or professional students are now eligible to borrow under the PLUS Loan Program up to their cost of attendance minus other estimated financial assistance in both the FFEL and Direct Loan programs. The terms and conditions applicable to Parent PLUS Loans also apply to Graduate/Professional PLUS loans. These requirements include a determination that the applicant does not have an adverse credit history, repayment beginning on the date of the last disbursement of the loan, and a fixed interest rate of 8.5 percent in the FFEL program and 7.9 percent in the Direct Loan program. Applicants for these loans are required to complete the Free Application for Federal Student Aid (FAFSA). They also must have applied for their annual loan maximum eligibility under the Federal Subsidized and Unsubsidized Stafford Loan Program before applying for a Graduate/Professional PLUS loan. *This program will be in effect for graduate or professional students for loans certified in the FFEL program or originated in the Direct Loan program on or after July 1, 2006.*

Rehabilitation of defaulted loans

§428F(a)

Currently, a borrower who wants to rehabilitate a defaulted loan is required to make 12 consecutive monthly payments on the loan. That requirement has been changed by the HERA, *effective on July 1, 2006*, to 9 payments made within 20 days of the due date during a period of 10 consecutive months, as established under a guaranty agency's loan rehabilitation agreement with the borrower. *All loan rehabilitation agreements beginning on or after July 1, 2006, must incorporate the 9 payments in 10 months standard.* (These changes do not apply to rehabilitation of defaulted Federal Perkins Loans.)

For a loan rehabilitation agreement that began prior to July 1, 2006, a guaranty agency will have the option of considering the borrower to have met the new rehabilitation standard if at least one of the borrower's payments is made (within 20 days of the due date) on or after July 1, 2006. However, the guaranty agency must treat all borrowers in this situation the same.

The HERA also specified that a guaranty agency may charge the borrower and retain collection costs in an amount not to exceed 18.5 percent of the outstanding principal and interest at the time of sale of the rehabilitated loan.

School lenders in the FFEL Program

§435(d)(2)

Effective April 1, 2006, the HERA limits the ability of schools to be lenders in the FFEL Program. As of that date, only a school that would have met the school lender eligibility requirements as they existed in section 435(d)(2)(A)-(F) on the day before the date of enactment of the HERA (*i.e.*, February 7, 2006) can be a school lender, and only if the school made FFEL loans as a lender on or before April 1, 2006.

As of February 7, 2006, a school lender --

1. Had to employ at least one person whose full-time responsibilities was limited to the administration of programs of financial aid for students attending that school;
2. Could not be a home study school;
3. Could not make loans to more than 50 percent of the undergraduate students at the school;
4. Could not make a loan, other than a loan to a graduate or professional student, unless the borrower had previously received a loan from the school or had been denied a loan by another eligible lender;
5. Could not have a cohort default rate greater than 15 percent; and
6. Had to use the proceeds from any special allowance payments received from the Department and interest payments from borrowers for need-based grant programs, except for reasonable reimbursement for direct administrative expenses.

Effective July 1, 2006, items 1 and 2 on the above list remain in effect, but item 3 has been eliminated, and items 4, 5, and 6 have been modified. On or after July 1, 2006, as a result of the changes made by the HERA, a school lender may make only subsidized or unsubsidized Stafford Loans under sections 428 and 428H to graduate or professional students enrolled at the school. Beginning on July 1, 2006, a school lender may not make PLUS loans to parents or to graduate or professional students, or make Consolidation Loans.

Effective July 1, 2006, a school lender must also comply with the following additional requirements:

1. Award any contract for financing, servicing, or administration of FFEL loans on a competitive basis;
2. Offer loans with an origination fee and/or interest rate that is less than the applicable statutory fee or rate *for any loan first disbursed on or after July 1, 2006;*
3. Maintain a cohort default rate that is not greater than 10 percent;
4. Submit an annual lender compliance audit, as described in 34 CFR 682.305(c), to the Department for any year in which the school engages in activities as an eligible lender; and
5. Use any special allowance payments, interest payments from borrowers, interest subsidy payments from the Department, and any proceeds from the sale or other disposition of loans for need-based grants. (School lenders are still authorized to use a portion of these payments or proceeds for reasonable and direct administrative expenses. Funds used for need-based grants must supplement, not supplant, non-federal funds the school would otherwise use for need-based grants.)

The compliance audit requirement contained in the HERA applies to all school lenders and does not include an exception based on the amount of the lender's loan volume each fiscal year, as is currently the case in 34 CFR 682.305(c) for other eligible FFEL lenders.

Teacher loan forgiveness

§428J
§460

The HERA has eliminated the previous termination date of October 1, 2005, for the increased Teacher Loan Forgiveness (TLF) amounts of up to \$17,500 for teachers in certain specialties and other eligibility criteria provided under the Taxpayer-Teacher Protection Act (TTPA) of 2004. The end date of October 1, 2005 for the increased loan forgiveness amounts and new eligibility requirements has been eliminated from the HEA and the changes made by the TTPA have been made permanent.

The HERA also amended the HEA in both the FFEL and Direct Loan programs to modify the rules for the eligibility of nonprofit private school teachers as highly qualified teachers who may qualify for the loan forgiveness. A teacher who is employed in a nonprofit private school and is exempt from state certification requirements may have such employment qualify for the loan forgiveness program if the teacher can demonstrate rigorous subject knowledge and skills by taking competency tests in the applicable grade levels and subject areas. The HERA requires that the competency tests be recognized by five or more states for the purpose of fulfilling the highly qualified teacher requirements under the No Child Left Behind Act of 2001 (“NCLB”), and that the score achieved by a teacher on each test equal or exceed the average passing score of those five states. The HERA makes no change for nonprofit private school teachers who are subject to state certification and who meet the highly qualified teacher definition under NCLB; they will continue to qualify for student loan forgiveness to the extent they meet the eligibility requirements. *This new provision is effective for applications received on or after July 1, 2006.*

For further information on the changes made by the TTPA, please review DCL GEN-04-14, December 2004: <http://ifap.ed.gov/dpcletters/GEN0414.html>.

TOPICS PRIMARILY AFFECTING LENDERS AND GUARANTY AGENCIES

Account maintenance fees

§458

For each of the fiscal years 2007 through 2011, account maintenance fees shall be paid quarterly and deposited in the guaranty agency’s Operating Fund established under section 422B, and shall not exceed 0.10 percent of the original principal amount of outstanding loans on which insurance was issued under the FFEL Program.

Administrative wage garnishment

§488A(a)(1)

Effective July 1, 2006, the limitation in section 488A(a)(1) on the amount of a borrower’s disposable pay that can be garnished has been increased from 10 percent to 15 percent. If a guaranty agency decides to increase the withholding rate with respect to borrowers

already being garnished at a lesser rate based on a garnishment proceeding pre-dating July 1, 2006, the agency must notify such borrowers that: (1) they can obtain a hearing upon request if they object to the increased withholding amount on the basis of undue hardship; and (2) a borrower who has new information not presented at the initial garnishment hearing may request a reconsideration of the existence or amount of the debt.

In general, a guaranty agency must follow the procedures described in 34 CFR 682.410(b)(9) for sending the notices to borrowers and employers and for scheduling a hearing for a borrower who chooses to have one.

College Access Initiative

§485D

Effective July 1, 2006, the HERA requires the Secretary to direct each guaranty agency to provide to the Secretary the information necessary for the development of Internet web links and access for students and families to a comprehensive listing of the postsecondary education opportunities, programs, publications, Internet web sites, and other services available in the states for which such agency serves as the designated guarantor. Each guaranty agency must develop and implement a plan to gather this information and to make the information available to the public and to the Secretary in a form and manner as prescribed by the Secretary.

Each guaranty agency must undertake the activities necessary to promote access to postsecondary education for students through providing information on college planning, career preparation, and paying for college. A guaranty agency shall publicize the information and coordinate with other entities that either provide or distribute such information in the states for which the guaranty agency serves as the designated guarantor. These activities may be funded from the guaranty agency's Operating Fund under section 422B and, to the extent funds remain, from earnings on the restricted account established pursuant to section 422(h)(4). A guaranty agency is not required to duplicate any efforts under way on the date of enactment of the HERA that meet the requirements specified in the HERA.

The Secretary will ensure that the information provided by guaranty agencies is made available to students, parents, and other interested individuals, through Internet web links or other methods prescribed by the Secretary. Guaranty agencies must ensure that College Access Initiative information is available without charge in printed format for students and parents requesting such information.

Not later than 270 days (*i.e.*, by November 5, 2006) after the date of enactment of the HERA, the Secretary and guaranty agencies shall publicize the availability of the College Access Initiative information, with special emphasis on ensuring that populations that are traditionally underrepresented in postsecondary education are made aware of the availability of such information.

Default collections

§428(c)

The HERA requires that, *on or after October 1, 2006*, a guaranty agency may not charge a borrower collection costs in an amount in excess of 18.5 percent of the outstanding principal and interest of a defaulted loan that is paid off through consolidation by the borrower, and shall remit directly to the Secretary that portion of the collection charge equal to 8.5 percent of the outstanding principal and interest of such defaulted loan. *On and after October 1, 2009*, a guaranty agency must remit directly to the Secretary the entire amount of the collection charge with respect to each defaulted loan that is paid off with excess consolidation proceeds.

The term “excess consolidation proceeds” is defined by the HERA to mean, with respect to any guaranty agency for any federal fiscal year beginning on or after October 1, 2009, the proceeds of consolidation loans received to pay defaulted Title IV loans for that agency that exceed 45 percent of the agency's total collections on defaulted loans in such federal fiscal year.

Effective July 1, 2006, the HERA requires that procedures be established to preclude consolidation payments from being an excessive proportion of a guaranty agency's recoveries on defaulted FFEL loans.

Escrow agent

§428(a)(3)(A)(v) and §428(i)(1)

Interest subsidy payments on loans disbursed by an escrow agent

Under the HERA, a lender may first receive interest subsidy payments on loans disbursed on behalf of the lender by an escrow agent on the date that is three days before the first disbursement of the loan. For this purpose, the Department interprets the word “disbursement” to mean disbursement to the institution or direct disbursement to the borrower. *This change is effective for all loan proceeds paid by a lender to an escrow agent on or after July 1, 2006.*

Lender payment of funds to an escrow agent

The HERA has reduced the time period prior to disbursement to the borrower that a lender may transfer loan funds to an escrow agent. A lender may now make payments of funds to the escrow agent no more than 10 days prior to the date the funds are disbursed to the borrower. *This change is effective for all loan proceeds paid by a lender to an escrow agent on or after July 1, 2006.*

Federal default fee

§428(b)(1)(H)

Effective for loans for which the date of guarantee of principal is on or after July 1, 2006, the HERA eliminates the optional 1 percent insurance premium fee that guaranty agencies could charge and establishes a Federal default fee equal to 1 percent of the

principal amount of the loan. The default fee must be deposited into the Federal Fund held by a guaranty agency under section 422A. The default fee shall be deducted and collected from the proceeds of the loan or by payment from other non-federal sources. If the borrower is charged the fee, it must be deducted proportionally from the loan proceeds.

A guaranty agency must ensure that the proceeds of the federal default fee will not be used for incentive payments to lenders. The Secretary is prohibited from waiving these provisions for guaranty agencies that have Voluntary Flexible Agreements under section 428A.

Forbearance agreements

§428(c)(3)

Effective for agreements entered into or renegotiated with a borrower on or after July 1, 2006, forbearance agreements no longer need to be approved in writing by the borrower. However, the lender must confirm any non-written agreement by sending a notice to the borrower and by recording the terms of the agreement in the borrower's file. The Department's regulations generally permitted this practice even before the HERA.

Interest repayment from lenders

§438(b)(2)(C)(v)

The HERA requires the repayment by a lender of excess interest paid by the Department when the applicable interest rate on a loan for any quarter exceeds the special allowance support level for the loan. The Department intends to collect the excess interest from lenders quarterly. *This requirement applies to loans for which the first disbursement of principal is made on or after April 1, 2006, but does not apply with respect to any special allowance payment made under section 438 before April 1, 2006.*

Excess interest is calculated each quarter by subtracting the “special allowance support level” from the applicable interest rate, multiplying the result by the average daily principal balance of the loan (not including unearned interest added to principal) during the quarter, and dividing by four. For example, if the average daily principal balance of a loan was \$1,000, and the applicable interest rate and special allowance support level were 6.8 percent and 5.8 percent, respectively, the excess interest to be rebated would be: $\$1,000 \times 1.0 \text{ percent} / 4 = \2.50 .

The HERA defines the term “special allowance support level” as a number expressed as a percentage equal to the sum of:

- The average of the bond equivalent rates of the quotes of the 3-month commercial paper (financial) rates in effect for each of the days in such quarter as reported by the Federal Reserve in Publication H-15 (or its successor) for such 3-month period, plus
- 2.34 percent for Stafford loans in repayment, or 1.74 percent during the in-school, grace, and deferment periods; or
- 2.64 percent for PLUS and Consolidation loans.

Lender insurance percentages

§428(b)(1)(G)
§428(I)

Beginning with loans for which the first disbursement of principal is made on or after July 1, 2006, a guaranty agency must insure 97 percent (a decrease from the current 98 percent) of the loan’s unpaid principal. However, a guaranty agency will continue to be required to insure 100 percent of the unpaid principal of loans made under a lender-of-last-resort program under section 428(j) or 439(q).

The insurance percentage applicable to lenders or lender servicers designated as exceptional performers under section 428I decreases from 100 percent to 99 percent for *any default claim submitted by the exceptional performer on or after July 1, 2006.*

Origination fees

§438(c)(2)
§455(b)(8)(A)

The HERA made changes to the HEA to reduce and eventually eliminate the origination fee that FFEL lenders are currently authorized to charge Stafford loan borrowers (Consolidation Loan borrowers are not charged this fee). The mandatory 3 percent origination fee will continue to be charged to PLUS loan borrowers.

Under current law, FFEL lenders are authorized to charge an origination fee of up to 3 percent of the amount of a Stafford loan. *Beginning with loans for which the first disbursement of principal is made on or after July 1, 2006, and before July 1, 2007, the maximum origination fee that can be charged will be 2 percent. The maximum fee drops to 1.5 percent on July 1, 2007, 1.0 percent on July 1, 2008, and 0.5 percent on July 1, 2009. The fee will be eliminated as of July 1, 2010.*

The HERA made similar reductions in the loan fee charged to Stafford borrowers in the Direct Loan Program. Stafford borrowers in the Direct Loan Program are subject to a 4 percent origination fee, which was comparable to the combined 3 percent origination fee + 1 percent insurance premium (now the Federal default fee) that may be charged to Stafford borrowers in the FFEL Program. *Beginning with loans for which the first disbursement of principal is made on or after February 8, 2006, and before July 1, 2007, the origination fee charged to Direct Stafford loan borrowers is 3 percent. (The*

Department has been providing this one percentage point origination fee reduction administratively.) This fee drops to 2.5 percent on July 1, 2007, 2.0 percent on July 1, 2008, 1.5 percent on July 1, 2009, and 1.0 percent on July 1, 2010. (NOTE: The Department will continue the existing "up front" interest rebate repayment incentive program for Direct Loan borrowers.)

Reinsurance claims from guaranty agencies

§428(c)(1)

Filing reinsurance claims

Effective for reinsurance requests filed on or after July 1, 2006, the amount of time a guaranty agency is allowed for filing a reinsurance claim to the Department has been reduced from 45 days to 30 days following the date the guaranty agency pays the lender's claim on the loan.

Exempt claims

For loans for which the first disbursement of principal is made on or after July 1, 2006, a guaranty agency will receive 100 percent reinsurance from the Department for exempt claims that it pays under new section 428(c)(1)(G). The term "exempt claims" is defined in section 428(c)(1)(G)(ii) to mean claims with respect to loans for which it is determined that the borrower (or the student on whose behalf a parent has borrowed), without the lender's or the institution's knowledge at the time the loan was made, provided false or erroneous information or took actions that caused the borrower or the student to be ineligible for all or a portion of the loan or for interest benefits on the loan.

Special allowance payments on tax-exempt loans

§438(b)(2)(B)

Effective on February 8, 2006, with the enactment of the HERA, certain special allowance payment provisions of the Taxpayer-Teacher Protection Act of 2004 have been made permanent.

Under the HEA, as it existed prior to the passage of the HERA, loans that were financed with funds obtained by the holder from the issuance of tax-exempt obligations originally issued prior to October 1, 1993 would be paid at the usual rates paid on other loans as specified in subparagraphs (A), (E), (F), (G), (H), or (I) of section 438(b)(2) if certain actions occurred after September 30, 2004, and before January 1, 2006. The HERA removes that January 1, 2006 ending date. The removal of that date from §438(b)(2)(B) now means that the special allowance rates on tax-exempt loans that were covered under §438(b)(2)(B) revert to the usual rates if those loans are:

1. Financed by a tax-exempt obligation described in section 438(b)(2)(B)(v)(I)(aa) that, after September 30, 2004, has matured or been refunded, retired, or defeased;
2. Refinanced after September 30, 2004, with funds obtained from a source other than funds described in section 438(b)(2)(B)(v)(I); or
3. Sold or transferred to any other holder after September 30, 2004.

In addition to these restrictions, the HERA added two additional provisions that prohibit a loan from being eligible for the 9.5 percent and minimum special allowance rates under section 438(b)(2)(B) if the loan was:

4. Made or purchased on or after the date of enactment of the HERA; or
5. Not earning a quarterly rate of special allowance determined under section 438(b)(2)(B)(i) or (ii) as of the date of enactment of the HERA.

Exception for certain holders

The HERA created an exception to the new restrictions in 4 and 5 above (but not to the first three restrictions) by substituting “December 31, 2010,” for the date of enactment if the holder:

- Was, as of February 8, 2006, and during the quarter for which the special allowance is paid, a unit of state or local government or a nonprofit private entity;
- Was, as of February 8, 2006, and during such quarter, not owned or controlled by, or under common ownership or control with, a for-profit entity; and
- Held, directly or through any subsidiary, affiliate, or trustee, a total unpaid balance of principal equal to or less than \$100 million on loans for which special allowances were paid under section 438(b)(2)(B) in the most recent quarterly payment prior to September 30, 2005.