STUDENT LOANS...

Proving Undue Hardship Bankruptcy Discharge: is that a student loan borrower's only option?

Other Options for Financially-Challenged Student Loan Borrowers:

Deferment, Forbearance, Repayment terms, Refinancing, Loan Cancellation & Administrative Discharge

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OVERVIEW OF TYPES OF STUDENT LOANS

For purposes of this discussion, there are loans financed by the U.S. Department of Education (ED or Education), and loans not financed by the U.S. Department of Education

Loans not financed by U.S. Department of Education:

- HEAL loans:[1] made by banks and other financial institutions, esp. Student Loan Marketing Association (Sallie Mae); guaranteed by U.S. Public Health Service/HHS: special non-dischargeability provisions (unconscionability).
  - HEAL loans can be included in a William D. Ford Federal Direct Consolidation Loan 34 C.F.R. § 685.220(a)(20)
- Private loans – made by banks and other financial institutions; may be guaranteed by either for profit guarantors (e.g. HEMAR, a Sallie Mae subsidiary) or non-profit guarantors, e.g. The Educational Resources Institute (TERI). *Note that status of guarantor affected dischargeability under 11 U.S.C. §523(a)(8) prior to effective date of BAPCPA[2] which made these loans included in 523(a)(8)*
- Scholarships with potential repayment obligations

Loans made under the programs financed by Education under Title IV of the Higher Education Act (HEA) of 1965

Historically, there have been numerous loan programs authorized under Title IV of the HEA:

Federally Insured Student Loan Program (FISLP)
Perkins Loan Program (formerly called the National Defense Student Loan Program and the National Direct Student Loan Program)
Federal Family Education Loan Program (FFELP)
William D. Ford Federal Direct Loan Program (Direct Loan Program)

**As will be discussed below, with recent legislative changes, only the Direct Loan Program and the Perkins Loan Program loans will be made after July 1, 2010.

[1] Health Education Assistance Loan Program (HEAL), established by the Health Professions Educational Assistance Act of 1976, Pub. L. 94-484. Authorization for new HEAL loans lapsed at the end of fiscal year 1995. Accordingly, no new HEAL loans were made after September 30, 1998.

[2] Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. 109-8, 1999 Stat. 23 (2005) (April 20, 2005), most provisions effective October 17, 2005.

FEDERALLY INSURED STUDENT LOAN PROGRAM (FISLP)

FISLP loans were made from 1965 until between 1980-1984. FISLP loans were made by financial institutions and directly reinsured by Education. Some FISLP loans remain outstanding.

Statutory Authority: 20 U.S.C. §§ 1077, 1079, 1080.

FEDERAL FAMILY EDUCATION LOAN PROGRAM (FFELP):[3]

While the Student Aid Fiscal Responsibility Act (SAFRA) and the Health Care and Education Reconciliation Act of 2010 (HCERA) eliminated the FFELP effective July 1, 2010, many FFELP loans remain outstanding. Thus, a working knowledge of the program as it existed and the varied participants is still both necessary and helpful.

Participants in the FFELP:

- **Initial Lenders**: FFELP loans were made by financial institutions, typically large banks, as well as some State agencies, and – for Consolidation Loans, the Student Loan Marketing Association (Sallie Mae)--and other special purpose loan corporations, sometimes through a trustee bank.

- **Secondary Lender Markets**: Most FFELP loans were sold by the originating lenders on the secondary market, often very soon after the loan was made. Some 70% of outstanding FFELP loans are held by secondary markets. Sallie Mae holds about 40% of all outstanding FFELP loans; other secondary markets include major banks and "student loan authorities. The latter typically hold beneficial ownership to the loans, while a trustee bank holds legal title. References in the HEA and FFELP regulations to "lender" include both originating lenders and secondary market purchasers.

- **Loan Servicers**: Loans are typically serviced for the holder by contractors ("loan servicers" or "third party servicers") who handle billing and other transactions. Sallie Mae, UNIPAC, ACS (which acquired AFSA), and several guaranty agencies service non-defaulted FFELP loans for banks and secondary markets.

[3] FFELP was formerly known (prior to 1992) as Guaranteed Student Loan Program (GSLP).

- **Guaranty agencies**: FFELP loans were directly guaranteed by State agencies or private non-profit organizations. Currently there remain some 36 guaranty agencies, of greatly varying size; some offer multi-state coverage, others operate mostly in one state. United Student Aid Funds is largest; California Student Aid Commission (CSAC) and its agent, EDFund is the “designated” guarantor for California.

- **Guarantor servicers**: Contractors who provide data management and other support services for guaranty agencies on non-defaulted FFELP loans guaranteed by and/or defaulted FFELP loans held by the guaranty agency.

- **Collection agencies:** Collection contractors (often referred to as “PCAs” (“private collection agencies”) in Federal debt collection parlance who provide dunning, skip-tracing, garnishment support and other services on a contingent fee basis both for guarantors and for the Education Department.

- **Credit Bureaus**: Credit Reporting Agencies, usually refers to the three major credit reporting agencies (Experian, Equifax and Transunion); the HEA requires holders of HEA loans to report the status of each loan to at least one national reporting agencies. See 20 U.S.C. 1080a (FFELP and Direct) and 1087cc(c) (Perkins).

- **Education Department**: reinsures guaranty agencies, pays lenders interest subsidies on need-based FFELP loans and, when needed to assure “market yield” to the lender, an added interest subsidy (special allowance payments) on all FFELP loans.

Legal authority:

- Statutory authority: Title IV-B of the HEA, 20 U.S.C. §§ 1071 et seq.
- Regulations: 34 C.F.R. Part 682

WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM (Direct Loan Program)

- Direct Loan Program loans initially made July 1, 1994
- Loans made directly by Education
- Direct Loan Program loan terms mirror terms of FFELP loans
- ED does use a contractor/servicer for the Direct Loan portfolio

Legal authority:

- Statutory authority: Title IV-D of the HEA, 20 U.S.C. § 1087a et seq.
- Regulations: 34 C.F.R. Part 685

TYPES OF FFELP AND DIRECT LOANS

- Subsidized Staffords (made to student borrowers, loan amount based on needs test)
- Unsubsidized Staffords [4](made to student borrowers, not based on financial need of the student)
- Parent Loan for Undergraduate Students (PLUS) (made to parents of dependent undergraduate student, not based on need, but require credit check and no adverse credit history) (more recently, PLUS loans made to graduate students)
- Consolidation Loans (made to all borrowers to pay off PLUS, Stafford, and in some instances other Consolidation loans)

PERKINS LOANS[5]

- loans made by postsecondary institutions from revolving loan fund capitalized by Federal funds from Education and matching institution contribution
- loans repayable to school; may be assigned to Education, usually after protracted period of default and numerous unsuccessful collection efforts by the school itself, including use of collection actions as needed
- several loan cancellation provisions specific to this loan program
- loans only to students

Legal Authority

- Statutory authority: Title IV-E of the HEA, 20 U.S.C. §§ 1087aa-1087hh
- Regulations: 34 C.F.R. Part 674

TITLE IV ANNUAL & AGGREGATE LOAN LIMITS

Stafford Subsidized and Stafford Unsubsidized Loans
FFELP 34 C.F.R. § 682.204(e) & (h)
Direct Loan Program 34 C.F.R. § 685.203 (e), (f), (g)

[4] Within the FFELP, formerly called Supplemental Loan for Students (SLS) (from 1986-1994) or Auxiliary Loan for Students (ALAS) (from 1980-1986).
[5]Formerly known as the National Direct Student Loan Program (from 1972-1987) (made pursuant to the HEA) or the National Defense Student Loan Program (NDSLP) (from 1958 to 1972) (made pursuant to the National Defense Education Act).

Annual and Aggregate Loan Limits
The following chart provides maximum annual and aggregate (total) loan limits for subsidized and unsubsidized Stafford Loans.

Year	Dependent Undergraduate Student (except students whose parents are unable to obtain PLUS Loans)	Independent Undergraduate Student (and dependent students whose parents are unable to obtain PLUS Loans)	Graduate and Professional Degree Student
First Year	$5,500—No more than $3,500 of this amount may be in subsidized loans.	$9,500—No more than $3,500 of this amount may be in subsidized loans.	$20,500—No more than $8,500 of this amount may be in subsidized loans.
Second Year	$6,500—No more than $4,500 of this amount may be in subsidized loans.	$10,500—No more than $4,500 of this amount may be in subsidized loans.	
Third and Beyond (each year)	$7,500—No more than $5,500 of this amount may be in subsidized loans.	$12,500—No more than $5,500 of this amount may be in subsidized loans.	
Maximum Total Debt from Stafford Loans When You Graduate (aggregate loan limits)	$31,000—No more than $23,000 of this amount may be in subsidized loans.	$57,500—No more than $23,000 of this amount may be in subsidized loans.	$138,500—No more than $65,500 of this amount may be in subsidized loans. The graduate debt limit includes Stafford Loans received for undergraduate study.

Note: These annual loan limit amounts are the maximum yearly amounts you can borrow in both subsidized and unsubsidized loans. You can have one type of loan or a combination of both. Because you can't borrow more than your cost of attendance minus any other financial aid you'll get, you may receive less than the annual maximum amounts. Also, the annual loan limits assume that your program of study is at least a full academic year.

The maximum annual and total loan limits include any Stafford Loans you may have received under the FFELP and the Direct Loan Program.

Graduate and professional students enrolled in certain health profession programs may receive additional unsubsidized Stafford Loan amounts each academic year beyond those shown above. For these students, there is also an increased aggregate loan limit of $224,000 (maximum $65,500 subsidized).

PLUS Loans
cost of attendance for student less other financial aid

Perkins Loan Program

Regulatory Authority: 34 C.F.R. § 674.12

Annual limit: $5,500/yr for undergraduate, $8000/yr graduate or professional

Aggregate: $27,500 for bachelor's degree program; $60,000 for graduate or professional program (to include any amounts for undergraduate)

REPAYMENT PLANS

Standard/Extended/Graduated Repayment Plans
(10-30 Years) (FFELP, Direct & Perkins)

- Regulatory Authority: 34 C.F.R. §§ 682.209(a)(7); 209(h)(2) (FFELP); 685.201(b)(1); 208(b)(1); 208(e) & (g)(4) (Direct); 34 C.F.R. 674.33(c) (Perkins)
- Monthly payments can be level or graduated for the payment term
- no payment larger than 3 x any other payment
- Payment Term: generally 10 years
  - FFELP & Direct: for balances over $30,000, payment period can extend up to 30 years
  - Perkins: if low-income borrower can extend to 20 years

Income Based Repayment Plan (IBR)
(FFELP & Direct)

- Regulatory Authority: 34 C.F.R. § 682.215 (FFELP); 685.221 (Direct)
- Loans NOT Eligible: loans in default, PLUS to Parent borrower and Consolidation if Parent PLUS loan included
- Initial Eligibility Requirement: Partial Financial Hardship
  - Calculation of PFH
    - Annual Amount Due All Eligible Loans under 10 Year Repayment > 15% X
      - X= AGI – 150% Poverty Guidelines For Family Size
  - Consent by Borrower for Tax Information
  - Certification of Family Size
- Monthly Payment
  - Maximum 15% of X/12
  - If not all eligible loans are Direct Loans, then payment amount is prorated between loan types (FFEL and Direct)
  - If < $5 payment is $0.00
  - If > $5 but < $10 payment is $10

- Payment Application: first to Interest Accrual, then to collection costs, then to late fees and then to principal
- Negative Amortization (Scheduled monthly payment amount doesn't cover the monthly interest accrual): permitted for up to 3 years (doesn't include time in an Economic Hardship Deferment)
- Loan Forgiveness: after 25 year repayment terms AND if meet repayment requirements
    - Public Service Loan Forgiveness (ONLY Direct Loan Program): after ten year repayment term if other requirements met

ED website allows estimate of monthly payments for IBR
http://studentaid.ed.gov/PORTALSWebApp/students/english/IBRCalc.jsp

ED website link to two-page PDF IBR Information is at
http://studentaid.ed.gov/students/publications/factsheets/factsheet_IncomeBasedRepayment.pdf

Income Contingent Repayment Plan (ICRP)
(all Direct except Direct PLUS and Direct PLUS Consolidation) (NOT FFFELP)

- ICRP is a **formula-based** approach to tailoring repayment burden to financial ability: available – currently – only under Direct Loan Program, not for FFELP. See 20 U.S.C. § 1087e(d)(1)(D).

- ICRP: borrower's annual repayment amounts are based on the income of the borrower **and, if married, his or her spouse**, and allows for payment over a **term of up to 25 years**. Any amount not paid by end of 25th year is cancelled. Amount cancelled under current view of IRS is taxable income in the year cancelled. HEA § 455(e)(4) directs ED to establish the terms of the income contingent repayment schedules by regulation; the schedules must vary the amount of installment payments required in relation to "the appropriate portion" of the annual income of the borrower and the borrower's spouse. 20 U.S.C. § 1087e(e)(4).

- Under this option, borrowers provide authorization to ED to secure their adjusted gross income data directly from the Internal Revenue Service annually. 20 U.S.C. § 1087e(e)(1).

- ICRP's flexibility was designed to make repayment affordable particularly for borrowers who take "lower-paying community service-type jobs." H.R. Rep. No. 111, 103d Cong. 1st Sess. 112, 121 (1993).

- PLUS loan borrowers (parents of dependent undergraduate students) are not eligible for income contingent repayment.

- ICRP Regulations: The scheduled monthly repayment amount required under income contingent repayment is set annually, in the following manner: (34 C.F.R. § 685.209(b), (c)).

  To establish the ICRP installment amount for a loan balance: *the practical way: go to ED website below, select Calculator button on left hand side of screen, and use the **ICRP Calculator**:*

  ED website allows estimate of monthly payments for a Direct Consolidation Loan: http://www.ed.gov/DirectLoan/index.html

ICR - *understanding **the concept***: two steps:

1. Establish the "**Pay Back Rate" amount**:

   - Find the installment payment amount needed to pay off the outstanding loan amount under a hypothetical 12-year level-payment amortization schedule.

   - Multiply that 12-year payoff installment amount (from step one) by a factor based on the borrower's income. For married borrowers with incomes roughly between $40,000 to $50,000, the factor is 1. The factor increases for borrowers with higher incomes, up to twice the 12-year level-payment amount, for those with incomes over $245,000.

   - The factor decreases for borrowers with lower incomes, down to 55% of the 12-year level-payment amount for those with incomes under $13,000.

   - The effect of the factor is to require more affluent borrowers to repay faster than a 12- year payback rate, and less affluent borrowers to repay more slowly than that required by a 12- year payback.

2. Determine the **actual monthly payment** under ICRP:

   - The monthly amount is based on the "payback rate" amount, but capped at 20 percent of the borrower's "disposable income."
   - Disposable income is adjusted gross income less the amount provided for a family of the same size as the borrower's under the HHS Poverty Guidelines.
   - The monthly installment payment for the individual borrower is based on the "payback rate" amount or 20% of the borrower's disposable income, whichever is less.
   - No payment is required if the computed payment would be less than $15.00 per month.
   - Unpaid accrued interest is capitalized up to 10% of the original loan amount, and then accumulates without capitalizing.

- Amounts that remain unpaid at the end of the 25th year of repayment (excluding any periods of deferment or forbearance) are cancelled; under current rules, this amount is taxable income to the borrower.

Comments on ICRP:

- **Who benefits from ICRP?** Taking the 12-year payback amount as "normal," ICRP demands higher than normal payments from those who have, and less from those who have not. The practical problem for middle-income borrowers is that ICRP identifies as "haves" borrowers with relatively modest income, and demands payback at rates that exceed those required under conventional 10 year level-payment amounts. As borrowers' family income decreases below $40,000, on the other hand, ICRP becomes more attractive option.

- **<u>Any</u> <u>student</u> loan defaulter can arrange to pay off <u>any</u> HEA loan or HEAL student loan debt by a Direct Consolidation Loan with ICRP terms**

    - **Parent PLUS borrowers cannot obtain ICRP terms**
    - **unless the loan is subject to judgment**

- In first two years on ICRP, alternative documentation of income may be required. 34 C.F.R. § 685.209(c)(2).

Pay As You Earn Plan ("PAYE")

- A new kind of income contingent repayment program that Ed first started offering on December 1, 2012. The regulations for PAYE will be effective on July 1, 2013, and will be included with the IRCP regulations in 34 C.F.R. § 685.209. Until that time, more information on the details of the plan is available at http://studentaid.ed.gov/repay-loans/understand/plans/pay-as-you-earn or in the Final Rule, 77 FR 66088 (November 1, 2012).

Income Sensitive Repayment Plan
(FFELP): ["ICRP lite"]

- Payments **<u>not</u>** based on formula (as in ICR), but set by agreement with the holder of the loan; payments may vary, but no payment may be greater than 3 times any other payment

- installment amount adjusted annually, based on borrower's expected income;

- loan must be repaid within otherwise applicable repayment timeframe, but lender can extend that timeframe for up to 5 years by exercise of forbearance. 34 C.F.R. § 682.209(a)(7), (8).

STUDENT LOAN DEFAULT AND CONSEQUENCES

When Default Occurs

- FFELP and Direct Loans: Failure to make required payment when due, if failure persists for 270 days: FFELP (20 U.S.C. § 1085(l); 34 C.F.R. § 682.200(b), and Direct: 34 C.F.R. § 685.102(b). Holder **always** accelerates the debt promptly after default.

- Perkins: Failure to make a payment when due: Perkins: 34 C.F.R. § 674.2(b); school **may** later accelerate the debt.

Who determines default?

- The party that holds the loan at the time that payments are due is the party that determines whether the borrower is in default.
- for FFELP, either lender/bank or secondary market
- for Direct Loans, ED
- for Perkins, the school

Credit Bureau Reporting

Statutory Requirement to Report: Holders of loans in all three loan programs must report the debt as delinquent or in default to national credit bureaus. See 20 U.S.C. § 1087cc(c) (Perkins); 20 U.S.C. § 1080a (FFELP and Direct).

Billing v. Collection Activity: Note difference between billing and collection activity (see Perkins rules for examples): for the FFELP, real collection activity starts only after loan has been declared in default, accelerated by the lender, and assigned by the lender to guaranty agency with a claim by the lender on the loan guaranty. For Perkins Loan Program, the school holds the loan before and after default; after about one year of delinquency, program rules require the school to change treatment of the loan from "billing" activity (dunning and phone contacts) to traditional collection (including referral to contingent fee contractors). Similarly Direct Loans remain held by Education, but after about one year of delinquency, recovery efforts on the loan are transferred from a servicing component to collections office.

Liability for Collection Costs and Use of Collection Contractors

Statutory Requirement: The HEA makes defaulters liable for "reasonable" collection costs. 20 U.S.C. § 1091a(b)(1). FFELP regulations direct each guarantor to compute "reasonable costs" using a "make-whole" method that computes the charge to each defaulter on the model of a guarantor-specific contingent fee. The charge to each defaulted FFELP debtor is assessed as a percentage of the loan balance, with that rate set to generate funds sufficient to reimburse the guarantor for the costs of collection efforts on its entire defaulted loan portfolio – not just on that individual loan. 34 C.F.R. § 682.410(b)(2). The regulations require the guarantor to offer the defaulter a brief initial

opportunity, after the default claim is paid, within which the debtor can agree to repay voluntarily, without liability for costs. (34 C.F.R. § 682.410(b) (5)(ii)).

Limits on Collection costs: The guarantor's collection cost charge is capped at the amount Education would charge if Education rather than the guarantor held the loan. As of the 2007 PCA Contract, ED's collections costs were at 19.35%.

- Note that regulations mandate a lower cap – 18.5% - for payoffs by Consolidation, 34 C.F.R. § 682.401(b)(27) or rehabilitation transfers, 34 C.F.R. § 682.405(b)(1)(iv)).

Use of Private Collection Agencies: Since 1981, Education has contracted for the services of private collection agencies (PCA) to support collection and resolution of defaulted student loans. Beginning in Fiscal Year (FY) 1998, Education established performance-based debt collection contracts, awarded after a competitive bidding process, where the contractors receive payment based on the volume of collections and other activities.

Bankruptcy – What Entity Holds the Loan?

When a borrower files for relief in bankruptcy, how Title IV HEA loans are handled, and by whom they are handled, differs depending on the type of loan, the type of bankruptcy filing, who held the loan when the debtor filed, and whether the loan is already in default when the petition for relief is filed.

For FFELP loans:

Chapter 7 and 11: The lender (bank or secondary market) that holds a FFELP loan must file a proof of claim, but retains the loan through the bankruptcy unless and until the debtor files an adversary seeking a dischargeability determination under 11 U.S.C. § 523(a)(8). If an adversary is filed, the holder then files a claim with the guarantor on the loan guaranty, and assigns both proof of claim and the loan to the guarantor. Education reimburses the guarantor for the full amount paid to the lender on the claim. The guaranty agency then defends the loan against discharge in the adversary proceeding.

> The FFELP framework never imposes on lenders any obligation to litigate or deal with litigation of any kind.

Chapter 12 and 13: The lender must suspend collection efforts, file a proof of claim in the bankruptcy, and then promptly claim on the guaranty and assign both the loan, and the proof of claim filed on the loan, to the guarantor. The guarantor pays the lender on the claim. Education reimburses the guarantor for the full amount paid to the lender on the claim. However, the guaranty agency defends the loan against discharge in any adversary proceeding.

For State guarantors, this duty may be accomplished by raising sovereign immunity as a defense to adversary proceedings claiming undue hardship, though a State GAs success with this argument is less likely after *Tenn. Student Assistance Corp. v. Hood,* 541 U.S. 440 (2004).

Non-defaulted FFELP loans held by guarantor: After the bankruptcy case is closed, either by dismissal or general discharge order, the guarantor must place any non-defaulted FFELP loans back with the claiming lender, or must sell the loan to another eligible lender, and must repay to Education any amount received from Education as Federal reimbursement for a claim on that loan.

The loan is treated as in forbearance during the stay period by the original lender (if that party holds the loan through the bankruptcy proceeding) or the purchasing lender. 34 C.F.R. § 682.402(f)(5)(ii). Interest accrues during this period and is capitalized unless paid as it accrues. 34 C.F.R. § 682.402(j)(2).

Defaulted FFELP loans held by guarantor: If a FFELP loan is already in default and held by the guarantor when the borrower files in bankruptcy, the guarantor must file a proof of claim that includes, in the amount in the proof of claim, a claim for collection costs, computed by the make-whole method described earlier. When the case is closed, the guarantor resumes collection activity on the loan.

Application of Payments: Payments received by the guarantor during the bankruptcy are generally applied just as they would be outside bankruptcy: first to collection costs (for defaulted loans), then accrued interest, and last to principal. 34 C.F.R. 682.404(f). Although bankruptcy law caps the amount that can be allowed on a claim with the bankruptcy estate at the amount owed at the filing date, which will not include post petition interest, the guarantor (and ED) apply payments to interest without regard to whether that interest accrued before or after the petition date. There is little, if any, practical difference for the borrower between this "business as usual" method, and applying payments solely to prepetition interest but carrying, and capitalizing, unpaid post petition interest, at the close of the bankruptcy. However, as a practical matter, borrowers should be aware that payment of the amount indicated by a student loan holder on a proof of claim with the bankruptcy estate will not pay the student loan debt in full.

Direct Loans

Education retains Direct Loans owed by individuals who file for relief in bankruptcy, and generally suspends collection action and files proofs of claim directly (or through the use of the contractor/servicer). Education relies on the assistance of the local U.S. Attorney's Office (USAO) in defending against discharge attempts, including objectionable plan language, as well as objections to proof of claims and allegations that the automatic stay was violated.

> ****Service of process note**: Bankr. R. 7001 and 7004 make F. R. Civ. P. 4 service requirements apply to adversary proceedings and to contested matters (e.g.,

motions for stay violations, preference recoveries, etc.). This requires service of a complaint or motion on the U.S. Attorney and the Attorney General, Bankr. R. 7004(4), as well as on the Secretary of Education. Bankr. R. 7004(5). Service on an Education contractor is not adequate service, nor is service on a regional Education office. The return address on most bills from Education is a contractor/servicer address, not an Education office.

Per Federal regulations, see 34 C.F.R. 4.1, the only proper office for service of process on the Secretary of Education is
Office of the General Counsel,
400 Maryland Ave. SW
Washington DC 20202.

Perkins Loans

The school similarly retains Perkins loans through the bankruptcy process, and, like a FFELP guarantor, is responsible for defending the debt against discharge. For State postsecondary institutions, this duty may be accomplished by resisting undue hardship claims on sovereign immunity grounds. After the case is closed, either by dismissal or general discharge order, the school resumes collection action. The loan is treated as in forbearance during the stay period. Interest accrues during this period and is capitalized unless paid as it accrues.

ECMC

The Educational Credit Management Corporation (ECMC) is a “special purpose” guaranty agency with a unique role in FFELP bankruptcies. ECMC is a non-profit Minnesota corporation formed in 1994 at time when it appeared that a number of guaranty agencies were in imminent danger of financial failure, and that a new guarantor would be needed to step in and assume loan guaranty responsibilities in those locales. Education has regularly assigned defaulted FFELP loans Education holds when the borrower files for relief in Chapter 13 to ECMC; ECMC takes title to the loan from Education, and pursues recovery both in the bankruptcy proceeding and, if the debt is not discharged, when the case is closed. ECMC then holds and collects those loans as would any other guaranty agency.

In 1998 amendments to the HEA, Congress reorganized the financial structure of guaranty agencies to divide in two the resources formerly considered to constitute the “reserve fund” of the guaranty agency. As pertinent, the HEA now requires guarantors to cover from their own resources (the “Operating Fund”) those costs they incur in defending FFELP loans from discharge in bankruptcy. Rather than absorb these costs, some guarantors, including CSAC, have been routinely assigning to ECMC those FFELP loans they already hold when debtors file for bankruptcy relief, or which they acquire from lenders through payment of bankruptcy claims. On these loans, ECMC takes assignment of the loan and any proof of claim filed on the loan, and thereafter defends the loans in bankruptcy and attempts recovery on those loans not discharged. As with

any other recoveries on defaulted Federally-reinsured FFELP loans, ECMC remits to Education, or holds subject to Federal direction, the "Federal share' of its recoveries on these loans. ECMC's Corporate In House Counsel and attorneys in Education's OGC work closely together on bankruptcy adversary matters. ECMC uses a network of local counsel to represent its interests in bankruptcy proceedings.

TIVAS: Title IV Agency Servicers

Passage of the Student Aid Fiscal Responsibility Act (SAFRA) and the Health Care and Education Reconciliation Act of 2010 (HCERA) brings important changes to the federal student loan programs. Of greatest impact, the legislation effectively ends the Federal Family Education Loan Program (FFELP) with no new FFELP loans being made after July 1, 2010.

These changes have greatly increased the loan servicing needs of Education (in addition to SAFRA, Education has funded or purchased approximately 80% of student loans made in @2007-2010 due to the troubles in credit markets). Education has contracted with four new servicers that you may be used to seeing servicing student loans that had not yet been assigned to Education: Great Lakes, PHEAA, Nelnet, and SallieMae. Education has also begun working with 11 non-profit loan servicers. (Although not new servicers, ACS and Vangent also service federally held debts and may be listed.)

Deferments & Forbearances: options available only for loans NOT in default status

Student loan borrowers facing financial difficulty in meeting repayment obligations can switch to another repayment plan available for their kind of loan, or suspend or modify that repayment schedule by means of deferments or forbearances.

- **Deferment** is a **suspension** for specific causes of the obligation to repay: the borrower is entitled to a deferment upon demonstrating that qualifications are met.
  - Regulatory Authority
    - FFELP 34 C.F.R. § 682.210
    - Direct 34 C.F.R. § 685.204
    - Perkins 34 C.F.R. § 674.34 et seq.
  - Each program has a variety of deferment grounds; several are focused on financial hardship, including unemployment deferment and economic hardship deferment, which are discussed more specifically below.
- **Forbearance** is a temporary **modification** of an established repayment schedule either for inability to meet the existing repayment obligations or other specified grounds. Forbearances can suspend all repayment, or can temporarily reduce the required

installment amount. Generally, forbearances are within the discretion of the lender and are not a right of the borrower.

- Regulatory Authority
  - FFELP 34 C.F.R. § 682.211
  - Direct Loan: 34 C.F.R. § 682.205
  - Perkins 34 C.F.R. § 674.33(d)
- Generally available where lender believes borrower intends to repay, but is unable to make scheduled payments because of poor health or other acceptable reasons.

- Loan Debt Burden Forbearance Required where student loan debt burden equals at least 20% of monthly income; limited to total of 3 years.

- Military mobilization or national emergency: Required where Education determines that military mobilization or national emergency affects borrower.

General comments on deferments and forbearances

- Deferments and forbearances are available prior to default and after rehabilitation or refinancing/reconsolidation, (which cure default – see below), but not while the loan is in default status.

- Deferments: for Subsidized Stafford loans government will pay the interest accruing during deferments. For Unsubsidized Staffords borrower is liable for accruing interest, which can be paid as it accrues or, if not paid, it will be capitalized, generally at the end of the deferment period.

- Forbearances: For Subsidized and Unsubsidized loans, debtor must pay the interest prior to end of forbearance period or it is capitalized (added to principal balance)

- Whether particular type of deferment or forbearance is available depends upon many factors, including when the loan was taken out and if borrower had prior loans

- In general, borrower is limited to up to maximum of three years per type of deferment. Forbearances may be granted for up to one year at a time, but FFELP regulations do not limit the cumulative amount of forbearance periods.

Economic Hardship Deferment

- available under all Title IV Loan Programs; 34 C.F.R. § 682.211(s)(6) (FFELP); 34 C.F.R. §685.204(b)(3) (Direct); 34 C.F.R. § 674.34(e)(Perkins).

- Borrower must be --
  a. receiving public assistance, or

b. working full-time (30 hours/wk or more) with low income - at or below the HHS Poverty Guideline amount for family of two, or
c. working full-time, with high debt/income ration: (monthly income – student loan debt) < $2289 (220% of amount in (b) - , or
d. not working full-time, with low income [less than $2971.60 - 2X amount in (b)] and monthly income net of student loan payments less than $1040.80 [amount in (b)].

[Note: (b), (c), and (d) formally require the qualifying income to be below the greater of the HHS Guideline amount or the minimum wage; the HHS Guideline amount now produces a larger amount than the minimum wage.]

Unemployment Deferment

available to borrower who is registered with unemployment agency if within 50-mile radius and has made at least 6 attempts during preceding 6 month period to secure full time work. 34 C.F.R. § 682.210(h)(FFELP); 34 C.F.R. §685.204(b)(2) (Direct); 34 C.F.R. § 674.34(d)(Perkins).

Options available without regard to default status of loan:

LOAN CANCELLATION

Service-based cancellation for Teaching and other public service work(Perkins): Perkins Loans may be partially or wholly canceled in return for qualifying teaching or other specific kinds of public service work. See 34 C.F.R. §§ 674. Cancellation rates and types of qualifying employment vary considerably depending on the type of loan and the period during which the loan was made.

> Borrowers whose loans are in default and have been accelerated may still qualify for cancellation, **but only for service performed prior to acceleration of the loan**. 34 C.F.R. § 674.52(c)(2). A borrower may obtain a cancellation only by written request to the holder of the loan together with documentation supporting the claim, typically a certification from the employer of the borrower. 34 C.F.R. § 674.52(a).

FFELP and Direct Loan borrowers may obtain limited cancellation for loans obtained no earlier than 1998, after five consecutive years of full-time teaching performed at least in part after 1997-98 school year. 20 U.S.C. §1078-10; 34 C.F.R. § 682.215 (FFELP); 34 C.F.R. § 685.215 (Direct). Borrowers who claim this relief should be referred to Direct Loan Service Center staff.

TOTAL AND PERMANENT DISABILIITY (TPD) DISCHARGE

CHANGES EFFECTIVE JULY 1 , 2013

Regulations governing disability discharge will change on July 1, 2013. The major change is for non-veteran borrowers. From July 1 forward, an application must contain either:

(i) A certification by a physician, who is a doctor of medicine or osteopathy legally authorized to practice in a State, that the borrower is totally and permanently disabled; or **(ii) An SSA notice of award for Social Security Disability Insurance (SSDI) or Supplemental Security Income "(SSI) benefits indicating that the borrower's next scheduled disability review will be within five to seven years.**

This tie to SSA determinations is new, and should simplify the discharge process for borrowers who have already received an SSA determination of disability.

Legal Authority: FFELP: 20 U.S.C. § 1087(a), 34 C.F.R. § 682.402(c)(1); Direct: 34 C.F.R. § 685.213; Perkins: 20 U.S.C. § 1087dd, 34 C.F.R. § 674.61

Definition of Total and Permanent Disability:

As most recently amended, for the Title IV HEA loan programs, an individual is considered totally and permanently disabled only if the individual is

> (1) Is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that—
>
> (i) Can be expected to result in death;
>
> (ii) Has lasted for a continuous period of not less than 60 months; or
>
> (iii) Can be expected to last for a continuous period of not less than 60 months; or
>
> (2) Has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected disability.

34 C.F.R. § 682.200 (b) (FFELP). See also 34 C.F.R. §§ 674.51(s) (Perkins) & 685.102(a)(3) (Direct Loan Program). A borrower **cannot** be considered totally and permanently disabled based on a condition that existed before receipt of the loan, **unless** that condition has substantially deteriorated since the submission of the loan application and has rendered the borrower totally and permanently disabled.

For FFELP and Direct Consolidation loans, this means that the Consolidation loan may be discharged only if the borrower would qualify for discharge of each and every one of the loans paid off by the Consolidation Loan.

Veteran's TPD Discharge

- ED began reviewing under this standard Aug. 14, 2008
- VA must have determined student loan borrower disabled/unemployable due to service connected disability
- Borrower submits ED TPD application with the VA documentation
- TPD Discharge is immediate, no post-discharge monitoring period

TPD Discharge for Non-Veteran Title IV HEA Borrowers

- Borrower submits original TPD application
    - WITHIN 90 DAYS of doctor's signature to ED
    - Doctor's License Status Verified[6]
    - Listed medical diagnosis Reviewed[7]
    - Borrower must sign each original
- Loan Holder forwards to ED's Disability Discharge Unit for Decision
    - Upon request, additional documentation to support a borrower's application for loan discharge in cases where the information provided in the initial application is not definitive, is illegible or is incomplete.
- APPROVAL FOR TPD DISCHARGE
    - ED notifies borrower
    - ED refunds monies paid after doctor's certification date to person who made the payment
    - POST DISCHARGE MONITORING PERIOD OF THREE YEARS
        - No new loans or TEACH grants after ED discharge date
        - Earnings from employment cannot exceed 100% of poverty line for family size of 2
    - REINSTATEMENT OF DISCHARGED LOANS

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[6] Doctors certifying a disability on a student loan must reside or be licensed to practice within the continental United States, American Samoa, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the Virgin Islands, the Commonwealth of the Northern Mariana Islands, the Republic of the Marshall Islands, the Federated States of Micronesia, and the Republic of Palau. The latter three are also known as the Freely Associated States. Doctors from outside the US cannot certify a total and permanent disability for purposes of discharging a student loan debt, even if the borrower lives outside the United States.

[7] ED requires a clear and complete diagnosis, in laymen's terms, of borrower's condition, including, as necessary, clarification (nature, severity and duration) of the diagnosis and how it will impact borrower's ability to work because of a medically determinable impairment.

- DENIED FOR TPD DISCHARGE

Applying for a TPD Loan Discharge

> Applications are available from the current holder of the loan, and should be returned ED to initiate processing of TPD application. Applications can be downloaded from http://www.ed.gov/offices/OSFAP/DCS/forms/disable.pdf.

OTHER ADMINISTRATIVE DISCHARGE RELIEF

Background of discharge relief under HEA § 437(c), 20 U.S.C. §1087(c).

In the early 1990's, a series of class actions were brought against holders of FFELP loans seeking relief on a variety of theories from loan liability by reason of school misconduct. In 1992 amendments to the HEA, Congress, unwilling to close off resolution of the pending lawsuits, yet reluctant to avoid any relief for borrowers injured by school misfeasance recently documented in the Nunn committee hearings, adopted the "loan discharge" provisions in HEA § 437(c). 20 U.S.C. § 1087(c). These discharge provisions, subsequently expanded in the 1998 HEA reauthorization, implicitly recognize that borrowers affected by school misconduct or non-performance (closure, failure to pay refunds, false certification of eligibility to borrow) were still legally obligated to repay the FFELP loans they had received to attend these schools. Relief is available for student borrowers, for parent borrowers if a student meets the eligibility standards, and for Consolidation Loan borrowers if a loan paid off by the Consolidation Loan would have qualified for discharge were it still outstanding. For unexplained reasons, the statute itself provided this relief only for loans made after January 1, 1986. Relief includes the following:

Closed School Discharge

Borrowers who received FFELP, Perkins or Direct loans on or after January 1, 1986 may qualify for a discharge of their obligation on those loans if they were unable to complete their education because the school in which they (or, for parent borrowers, the students for whom the loans were received) were enrolled closed or if they withdrew during a 90-day period of "constructive closure" preceding the closing date. HEA § 437(c), 20 U.S.C. § 1087(c) (FFELP); §464(g), 20 U.S.C. § 1087dd(g) (Perkins); and 34 C.F.R. § 685.213 (Direct). Relief is available upon satisfactory showing of eligibility by application to ED, or, for loans not held by ED, to the cognizant guaranty agency. Eligibility and procedures are set forth at 34 C.F.R. § 682.402(d). Relief includes refund of any payments made on the loan, reinstatement of eligibility for future Title IV, HEA student assistance, and expunging of adverse information disseminated on the loan to credit bureaus. Older (pre-January 1986) FFELP loans may qualify for pro-rated relief.

False Certification Discharge

Borrowers who received FFELP loans after January 1, 1986 may obtain a discharge of their obligation if the school for which the loans were received falsely certified their eligibility to borrow. 20 U.S.C. § 1087(c). Relief is available by application to ED, or, for loans not held by ED, to the cognizant guaranty agency through procedures set forth at 34 C.F.R. § 682.402(e). Relief includes refund of any payments made on the loan, reinstatement of eligibility for future Title IV, HEA student assistance, and expunging of adverse information disseminated on the loan to credit bureaus. The same relief is available for Federal Direct Loan borrowers. 34 C.F.R. § 685.214.

Ability to Benefit (ATB)

ED applies the false certification discharge provision first to those determinations of student eligibility made by the school attended by the borrowers (or, for parent borrowers, the student for whom the loan was received) that the student, although lacking a high school diploma or GED, was nevertheless an "eligible student" under the FFELP because the student nevertheless had the ability to benefit from the training offered from the school. 34 C.F.R. § 682.402(e). A borrower qualifies for loan discharge if the school's determination that the student had the ability to benefit was improperly made.

False Signature

Relief under §437(c) is also available, under ED regulations, for a FFELP or Direct loan borrower whose loan application or promissory note was signed by the school without the borrower's authorization, upon satisfactory application to ED or the guarantor. 34 C.F.R. §§ 682.402(e); 685.214(c)(2).

Forgery of Disbursement Check

Loan relief is available under the False Certification procedure for forgeries on disbursement instruments. This includes claims that the school forged the FFELP or Direct loan borrower's endorsement on a loan disbursement check or on an authorization for the loan funds to be disbursed electronically. Relief is not given if the borrower received the proceeds of that loan either directly or by credit satisfying a tuition obligation owed to the school. 34 C.F.R. § 682.402(e)(1)(ii); § 685.214(c)(3).

Unpaid Refunds

Borrowers who received FFELP or Direct loans on or after January 1, 1986 may, under § 437(c), obtain a partial discharge of their loan obligation if the school they attended failed to make a refund that would have been applied to reduce their loan balance. 20 U.S.C. § 1087(c). As with other discharge relief, the borrower must file an application with ED or the cognizant guaranty agency for discharge relief. 34 C.F.R. § 682.402(l)(FFELP); 34 C.F.R.R 685.212(f) (Direct).

Identity Theft

Loan relief is available for student loan borrowers (FFELP and Direct) whose identity has been stolen. As with other discharge relief, the borrower must file an application with ED. 34 C.F.R. § 682.402(c)(14) (FFELP) & 685.215(a)(iv) & (c)(4) (Direct Loan Program).

Administrative Relief Only

Discharge relief claims of any kind **must** be presented through the administrative process created by ED regulations and cannot be obtained by a suit brought for affirmative relief or asserted as a defense to a collection claim in litigation. *In re Scholl*, 239 B.R. 345 (Bankr. N.D. Iowa 2001)(closed school claim); *U.S. v. Wright,* 87 F.Supp.2d 464 (D. Md. 2000); *U.S. v. Bertucci*, C.A. No. 00-0078, 2000 U.S. Dist. LEXIS 12877 (E.D. La., Aug. 30, 2000) (unpaid refund claim); *In re Bega*, 180 B.R. 642 (Bankr. D. Kan. 1995). There is no limitation period for such a claim, and no prohibition on relief even if the loan has been reduced to judgment; raising a claim for discharge relief is therefore no basis for delay in entry of judgment on the debt. *U.S. v. Green*, No. 1:99 CV 53-C, 2000 U.S. Dist. LEXIS 3297 (W.D. N.C. Feb. 9, 2000).

> To download application forms for these administrative discharges, go to ED site at http://www.ed.gov/offices/OSFAP/DCS, **select Forms, then select the application described for that discharge relief.**

Options for Refinancing Student Loan Debt and Curing Default

Consolidation Loans: The Basics

- Borrowers can obtain a Consolidation Loan from ED to pay off qualifying education loans, usually over substantially longer terms, based on loan amount, than were available on the original loans (see above). 20 U.S.C. §1078-3(c)(4). Interest rate on the Consolidation Loan is the weighted average of the rates on the outstanding loans at the time the Consolidation Loan is made.

- **Some** Non-HEA Title IV loans may be consolidated into a Direct Consolidation Loan; e.g., HEAL Loans. 34 C.F.R. § 685.220(b)(19). **Private loans** (loans from TERI *et al*.) **cannot** be paid off by an ED Consolidation loan.

- Borrowers with an outstanding Direct Loan are eligible for a Direct consolidation loan. Other borrowers - those who do not have a Direct Loan - must first attempt to obtain a FFEL Consolidation Loan from a FFELP lender, but can obtain Direct Consolidation Loan if they are unable to obtain an FFELP Consolidation Loan, or - for all but PLUS borrowers - if they would qualify for income contingent repayment on a Direct

Loan, but cannot obtain a FFELP Consolidation Loan with income-sensitive repayment terms. 34 C.F.R. §§ 685.208(a), 685.215(d)(1)(I).

<u>Special considerations for Defaulters</u>:

- Applicants for FFEL Consolidation cannot be subject to a judgment on a Title IV loan or an administrative wage garnishment order under HEA§ 488A. 20 U.S.C. §1078-3(a)(3).

- A defaulted borrower who makes satisfactory arrangements to repay the defaulted loan can obtain a FFELP or Direct Consolidation Loan. 34 C.F.R. § 682.201(c)(1) (iii)(C) (FFELP); 34 C.F.R. 685.215(d)(1) (ii)(E) (Direct).

- A defaulted borrower may become eligible for a Direct Consolidation Loan without first making the series of payments otherwise required if the borrower agrees to pay the loan under the income contingent repayment plan. 34 C.F.R. § 685.215(d)(1) (ii)(F).

- **To apply for a Consolidation Loan**, borrowers should contact a FFELP lender or, for a Direct Consolidation Loan, the Direct Loan Servicing Center (800-848-0979), or download a Direct loan application from http://loanconsolidation.ed.gov/forms.html.

- **E-sign loans**: Applicants can apply for a Direct Loan on line, and execute the transaction, including signing the promissory note, electronically – on line. To do so, the applicant must have PIN from Education; the PIN can also be obtained on line.

<u>Some considerations about Consolidation</u>:

- **The amount borrowed** under the Consolidation Loan must be large enough to pay off the outstanding loans in full, including all accrued and outstanding interest and – for those in default - any collection costs incurred as a result of that payoff. The costs incurred or that payoff will typically arise from, or are figured as, a contingent fee or commission – as a percentage of the payment from the proceeds of the Consolidation Loan.

- **Collection cost charges for defaulted borrowers**: Regulations cap at 18.5% the Consolidation Loan borrower's liability for collection cost charges on the outstanding defaulted loans being paid off by the Consolidation Loan. This is less than the rate typically charged on those loans if they remained outstanding and collected by the guarantor. The amount borrowed in the new, Consolidation Loan must therefore be sufficient to pay off all outstanding principal and interest, as well as the collection costs incurred for the payoff, of the outstanding defaulted loans. Interest will accrue on that new (larger) balance, not simply on the principal that was owed on the loans paid off by that Consolidation Loan.

- **ED charges**: Note that ED currently charges 12% for collections costs incurred in those instances in which the new Consolidation Loan is arranged by a contractor under

circumstances in which ED owes the contractor a commission. No commission is earned if the borrower obtains the new Direct Consolidation loan only by agreement to income contingent repayment terms, and therefore no collection costs are incurred or added in that instance.

- **Interest rates: I**n all instances, the new Consolidation Loan has a fixed interest rate that is the weighted average of the rates in effect on the loans being paid off.

- **Potential effect on disability claims**: A borrower who consolidates several loans cannot obtain a disability cancellation of the consolidation loan if the borrower would not qualify for discharge on each of those original loans paid off by the Consolidation Loan.

If a borrower and spouse take out a single Consolidation Loan to pay off both their outstanding loans, **both** must sign the new promissory note, and both are individually and jointly liable for the entire new debt. A spouse who subsequently becomes disabled can obtain a disability discharge of his or her respective portion of the Consolidation loan. Notably, joint consolidation loans are no longer made.

Rehabilitation of defaulted HEA loans

FFELP Loan Rehabilitation

a repayment process for curing a default by nine payments within 20 days of the due date over ten consecutive months **and** by then having the guarantor sell the loan to a lender. The guarantor reinstates the loan guaranty upon sale to the lender, and the borrower then regains all the benefits of the original loan, such as rights to deferment and cancellation, that were lost when the loan defaulted. *The loan is rehabilitated only when it has actually been sold*. The loan may then be repaid under a new repayment schedule; the borrower may be required to sign a new promissory note.

Authority: Section 428F(a) of the Higher Education Act of 1965, as amended, 20 U.S.C. §1078-6(a); 34 C.F.R. § 682.405

The amount of the installment payments needed to qualify for rehabilitation must be "reasonable and affordable" based on the borrower's "total financial circumstances," as assessed by the guarantor. This is an ad-hoc, financial-statement based evaluation, unlike the formulaic ICRP.

Some payment must be made, but no pre-set minimum amount can be required. Amounts recovered by administrative wage garnishment or any other non-voluntary payment do not count toward these 12 qualifying payments. Loans reduced to **judgment** are not eligible for rehabilitation unless and until the guarantor, in its discretion, agrees to vacate the judgment and reinstate the loan as the basis of the debtor's obligation.

Separate rules apply for Perkins and Direct loans (see below): neither the school (Perkins) nor the Department (Direct) sells the loan when the qualifying payments have been made, but rather both restore the rehabilitated loan to normal servicing. Pell Grant overpayment debts cannot be rehabilitated.

Credit bureau reference by the guarantor or ED showing the loan as a defaulted student loan is deleted when the rehabilitation is complete; purchasing lender will report loan as current. However, the original lender's report of the loan as in default and paid by government guarantee will remain on credit bureau record until seven year limitation period for adverse credit information under Fair Credit Reporting Act lapses as to that lender's report.

Borrower regains eligibility for Title IV HEA student aid.

Interest rate remains same as original promissory note.

Direct Loan Rehabilitation

Authority: 34 C.F.R. § 685.211(e) (Direct Loans)

Allows a Direct Loan to be automatically restored to normal servicing, with default status cured, by making nine payments within 20 days of the due date over ten consecutive months. Unlike FFELP, Direct Loan rules do not require a borrower to specifically request rehabilitation; rehabilitation for Direct Loans occurs automatically upon completion of the 12 qualifying payments.

Borrower regains eligibility for Title IV Aid.

ED notifies Credit Bureaus to deleted previous reports of the loan as in default.

The debtor is liable for collection costs on individual qualifying payments (at the normal rate) up to the point at which the loan is rehabilitated, but not thereafter, unless the debtor defaults again.

Borrower continues paying ED until notification received from Direct Loans to send payment to Direct Loan Program again.

Education applies any voluntary payments made after rehabilitation to the loan; Education refunds any involuntary payments it receives after Rehabilitation occurs.

Perkins Loan Rehabilitation

Authority: 20 U.S.C. § 1087dd(h), 34 C.F.R. § 674.39.

12 qualifying payments; borrower liable for collection costs of up to 24% of the unpaid balance at time of 12th payment, which amount becomes part of the debt to be repaid thereafter.

Comments on Rehabilitation:

Borrowers qualify for repayment installments under rehabilitation agreements that are “reasonable and affordable” based on their individual financial ability – not on any required amortization schedule. After the loan is sold, however, the loan must be repaid under a conventional 10-year repayment schedule, which began with the first of the qualifying 12 payments – leaving 9 years to repay the loan in full. The holder of the loan after rehabilitation: the purchasing lender (for FFELP), the school (for Perkins), or the Department (for Direct) must establish a repayment schedule that will actually amortize the loan over that 9 year term, with limited flexibility to extend by means of a forbearance agreement for reduced payments. This may well require substantially larger payments from the borrower after rehabilitation than were permitted for the 12 qualifying payments, and may exceed the borrower’s ability to pay.

At the point of rehabilitation, the guarantor (for FFEL loans) adds to the principal of the loan any collection costs incurred for the sale, those guarantor costs – capped at 18.5% of the principal and interest owed at the time of sale - are therefore capitalized and incur interest. Similarly, the Perkins school adds an amount capped at 24% of the principal and interest then owed.
(Note that ED currently adds no collection costs or fees on any defaulted loans it holds when they are rehabilitated).

- Consider whether the borrower actually needs the benefits of rehabilitation – chiefly a potentially improved credit record.

****Two strikes and you’re out**: A borrower can rehabilitate a loan only one time under this provision. If the borrower defaults again on that loan, rehabilitation is not available. 20 U.S.C. 1078-6(a)(5).

Reinstatement Of Eligibility For New Title IV HEA Student Aid

Authority: 20 U.S.C. § 1078-6(b); 34 C.F.R. § 668.35(a)(2); 682.201(a) (FFELP); 34 C.F.R. § 674.9(a) (Perkins); 34 C.F.R. § 685.200(c) (Direct Loans).

Satisfactory repayment arrangements consist of making of six consecutive, voluntary, on-time, full monthly payments on a defaulted loan. See 34 C.F.R. § 682.200 (FFEL); 34 C.F.R. § 674.2 (Perkins); 34 C.F.R. § 685.102 (Direct Loans).

Monthly Payment Amount: an amount satisfactory to the loan holder (ED, the guarantor, or the school that made the loan) based on financial documents from debtor; no set minimum amount required.

Voluntary Payments: payments obtained through offset and garnishment are not considered voluntary but those payments can be considered by the loan holder in establishing a monthly payment amount

****Two strikes and you're out**: A borrower can regain eligibility only one time under this provision. If the borrower defaults again on that loan, reinstatement of eligibility is not available. 20 U.S.C. § 1078-6(b).

ADMINISTRATIVE WAGE GARNISHMENT (AWG)

Federal law now authorizes guarantors and Education to collect defaulted loans they hold by non-judicial, "administrative" wage garnishment. Defaulters who do not come to repayment terms with the guarantor (for FFELP loans) or Education (for any loan held by ED) ultimately face enforcement by wage garnishment.

Legal Authority: HEA and DCIA

- Section 488A of the HEA, 20 U.S.C. § 1095a authorizes both guarantors and ED to garnish up to 15 percent of the disposable pay of the debtor by an administrative order, without need for a judgment. Federal regulations require guarantors to use this tool, which is now the primary means of enforcing defaulted FFELP loans. 34 C.F.R. 682.410(b)(9). (Perkins schools do not have this authority.)
- The Debt Collection Improvement Act of 1996, 31 U.S.C. § 3720D, a virtual clone of the HEA garnishment authority, which authorizes Federal agencies, such as Education, to garnish up to 15 percent of disposable pay. Education adopted regulations for this authority, 34 C.F.R. Part 34, 68 FR 8141 (2003), and has relied on this authority for AWG Orders since approximately 2004.

Both the HEA and DCIA require that the debtor be given notice of any proposed garnishment action, an opportunity to avoid garnishment by repaying voluntarily, and a hearing, on request, to dispute both the existence and amount of the debt, and whether withholding at the full rate authorized (10 percent under the HEA; 15 percent under the DCIA) would cause financial hardship. These rights are spelled out in the notices sent prior to garnishment.

Guarantors are free to use any method of evaluating hardship claims; some may use an ad hoc, financial statement-based approach; others, and Education itself, use a method based on the standards adopted by the IRS for offers in compromise under IRC § 7122(c)(2). [8] Education encourages, but does not require, guarantors to use this method.

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[8] Education and the guarantors that employ this method use it only to measure the reasonableness of expense claims, and not to determine the amount of debt that the individual will be required to repay to satisfy his or her obligation.

Under this standards approach, a debtor who claims that garnishment at the full 15 percent rate of his or her disposable pay would cause financial hardship to him or her and his dependents must document the debtor's household expenses and income. The garnishment order reaches only the debtor's wages, but whether garnishment of the debtor's wages will cause financial hardship to the debtor and his or her dependents requires consideration of both the household income as a whole, as well as the household expenses. The debtor's expenses are then compared by the guarantor or ED with the amounts identified in the IRS standards as the average amounts spent for those same expenses by families of the same size and similar income as the debtor's. Using data from census and other empiric sources, the standards determine average housing expenses on a county-by-county basis; transportation expenses, on a regional basis; and personal expenses, on a national basis. A debtor who claims to need to spend more for a particular kind of expense than the average amount spent by families in his or her cohort of the standards bears the burden of persuasion that the added amount is necessary.

Education uses the standards method in garnishment proceedings both to determine the terms of voluntary repayment agreements and the amount to be withheld when agreement cannot be reached:

Repayment agreements:

- For those debtors who respond to a garnishment notice by seeking to repay voluntarily and do not claim hardship, Education generally is willing to accept – without documentation of expenses - an installment payment arrangement under which the debtor agrees to repay in installment amounts equal to amount collectible at the full garnishment rate authorized (15% of disposable earnings). Current pay stubs are sufficient to establish the amount of disposable earnings of the debtor. The repayment terms are subject to reevaluation periodically.

- For those debtors who respond to a garnishment notice by claiming hardship but indicate a willingness to repay voluntarily, the Department is willing to accept – upon documentation of income and expenses – an installment payment amount based on available income after necessary household expenses, measured against the standards, are met. If no amount appears available after expenses are met, the Department suspends attempts to garnish. Any repayment agreement or suspension of enforcement action is subject to reevaluation periodically, typically at six-month intervals.

Amount to be withheld by garnishment order:

For those debtors who object to garnishment on hardship grounds but do not agree to repay voluntarily, the Department uses the standards in the hearing process to evaluate the hardship claim. Based on that evaluation, the hearing official may order withholding at less than the full amount authorized by statute, or may determine that withholding in any amount will cause hardship, and decide that no garnishment should occur. Again, a partial or complete hardship determination is subject to reevaluation periodically; if Education later determines that the financial circumstances no longer show that repayment would cause hardship, the Department will resume enforcement action,

starting with a new notice of proposed garnishment, and an additional opportunity to object to that demand.

TREASURY OFFSET PROGRAM (TOP)

TOP is a centralized debt collection program, authorized pursuant to the Debt Collection Improvement Act, developed and run by the U.S. Department of Treasury (Treasury) to help Federal agencies collect some $50 billion of delinquent debt owed to the Federal government. Through the Treasury Offset Program, Federal payments are withheld to satisfy delinquent Federal debt. The Financial Management Service (FMS), a bureau within Treasury, makes over 850 million dollars in payments a year on behalf of over 400 Federal agencies. Since 1986, Education has referred millions of defaulted FFELP debts to Treasury for collection through TOP, or its predecessor, the Tax Refund Offset Program.

Education can use TOP to collect both debts ED holds and debts held by third parties as agents for the Federal government—guaranty agencies. For TOP purposes, student loan guarantors hold and collect FFELP loans on which Education has already paid Federal reinsurance as agents for the Federal government, and Education refers to Treasury for offset in TOP the Federal claims on these reinsured FFELP loans held by the guarantors.

As with AWG, ED notifies defaulted student loan borrowers of its intent to collect through TOP. Borrowers are provided the opportunity to object to collection via offset. Borrowers can enter into a repayment agreement and can also claim financial hardship.

If an offset is actually taken by FMS and credited to an ED debt, Treasury provides the debtor, at the time the offset is taken, with a courtesy notice of the offset and to what entity the offset was sent.

OFFICE OF THE FSA OMBUDSMAN

Education's Federal Student Aid Office of the Ombudsman is an excellent resource for any borrower having questions about their loans, the servicing history of the loans, eligibility for deferments, forbearances, rehabilitation and the like. The Ombudsman Specialists are extremely knowledgeable.

FSA's Ombudsman webpage is http://studentaid.ed.gov/repay-loans/disputes/prepare