DEPARTMENT OF EDUCATION

34 CFR Part 682

RIN 1840–AC35

Federal Family Education Loan Program; Due Diligence Requirements

AGENCY: Department of Education.

ACTION: Final regulations.

SUMMARY: The Secretary amends the regulations governing the Federal Family Education Loan (FFEL) Program. The FFEL regulations govern the Federal Stafford Loan Program, the Federal Supplemental Loans for Students (Federal SLS) Program, the Federal PLUS Program, and the Federal Consolidation Loan Program, collectively referred to as the Federal Family Education Loan Program and authorized by Title IV, Part B of the Higher Education Act of 1965, as amended (HEA). The Secretary is making changes to the due diligence requirements for lenders and guaranty agencies participating in the FFEL Program.

DATES: *Effective date:* Except for the revision of § 682.404(f), these regulations take effect on July 1, 1997. The revision of § 682.404(f) is effective January 1, 1998 and applicable for payments received on or after January 1, 1998. However, affected parties do not have to comply with the information collection requirement in § 682.411 until the Department of Education publishes in the Federal Register the control number assigned by the Office of Management and Budget (OMB) to this information collection requirement. Publication of the control number notifies the public that OMB has approved this information collection requirement under the Paperwork Reduction Act of 1995.

FOR FURTHER INFORMATION CONTACT: Ron Streets, Program Specialist, Loans Branch, Policy Development Division, Policy, Training, and Analysis Service, U.S. Department of Education, 600 Independence Avenue, SW. (room 3053, ROB–3), Washington, DC 20202–5449. Telephone: (202) 708–8242. Individuals who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1–800–877–8339 between 8 a.m. and 8 p.m., Eastern time, Monday through Friday.

SUPPLEMENTARY INFORMATION:

Background

The Secretary is amending 34 CFR Part 682 of the Department's regulations to improve the administration and the integrity of the FFEL Program. By improving program efficiency, these regulations will reduce burden for lenders and improve the collection of outstanding FFEL loans and potential liabilities owed to the Secretary.

On September 6, 1996, the Secretary published a notice of proposed rulemaking (NPRM) for Part 682 in the Federal Register (61 FR 47398). The NPRM proposed changes needed to improve the due diligence provisions in the FFEL program. The NPRM included a discussion of the major issues surrounding the proposed changes, and the discussion will not be repeated here. The following list summarizes those issues:

- Guaranty agency retention of collection costs of a defaulted FFEL loan that are repaid by a consolidation loan;
- Requiring a guaranty agency to offer preclaims assistance to lenders no later than the 75th day of delinquency;
- Requiring a guaranty agency to provide counseling and written consumer information to the borrower by the 100th day of delinquency;
- Application of payments made by a borrower on a defaulted loan to a guaranty agency;
- Requiring a guaranty agency to assess a defaulted borrower the same amount of collection charges assessed by the Department;
- Initiating wage garnishment proceedings for borrowers with sufficient income;
- Expanding the length of time in which lenders must send the first written notice or collection letter to a delinquent borrower;
- Modifying the requirements for the two collection letters that must be sent to a borrower; and
- Expanding the possible remedial action available to the Secretary if a guaranty agency fails to meet the requirements of § 682.410 to include mandatory assignment of FFEL loans to the Department at the Secretary's discretion.

Substantive Revisions to the Notice of Proposed Rulemaking

Section 682.404 Federal Reinsurance Agreement

The Secretary amends this section of the regulations to require guaranty agencies to provide preclaims assistance to lenders no later than the 90th day of delinquency. The NPRM had proposed a deadline of the 75th day of delinquency.

This section has also been amended to require that a guaranty agency provide counseling and consumer information to a borrower within 10 days following the receipt of a preclaims assistance request from the lender or the servicer. The Secretary has further amended this section to allow guaranty agencies flexibility in using formats other than written ones when providing consumer information to the borrower as part of the guaranty agency's preclaims assistance.

Section 682.410 Fiscal, Administrative, and Enforcement Requirements

The proposal to require a guaranty agency to charge a borrower collection costs equal to the amount the same borrower would be charged for the cost of collection if the loan was held by the Department has been removed. The Secretary has retained the current regulatory requirement which allows a guaranty agency to use the lesser of the amount derived from the formula in 34 CFR 30.60 or the amount charged by the Department.

Section 682.411 Due Diligence by Lenders in the Collection of Guaranty Agency Loans

Section 682.411 is also amended to move the last sentence in paragraph (c) in the NPRM that deals with the contents of the first delinquency notice and insert it in paragraph (d), and to add a modified statement to paragraph (c).

Executive Order 12866

1. Assessment of Costs and Benefits

These final regulations have been reviewed in accordance with Executive Order 12866. Under the terms of the order the Secretary has assessed the potential costs and benefits of this regulatory action.

The potential costs associated with the final regulations are those resulting from statutory requirements and those determined by the Secretary as necessary for administering this program effectively and efficiently. Potential costs and benefits are also discussed in conjunction with the public comments to which they relate.

In assessing the potential costs and benefits—both quantitative and qualitative—of these regulations, the Secretary has determined that the benefits of the regulations justify the costs.

Analysis of Comments and Changes

In response to the Secretary's invitation in the NPRM, 38 parties submitted comments on the proposed regulations. An analysis of the comments and of the changes in the regulations since publication of the NPRM follows. An analysis of the comments received regarding the

regulatory flexibility certification can be found under the heading *Regulatory Flexibility Act Certification.*

Major issues are grouped according to sections and subject. Other substantive issues are discussed under the section of the regulations to which they pertain. Technical and other minor changes—and suggested changes the Secretary is not legally authorized to make under the applicable statutory authority—are not addressed.

Section 682.401—Basic Program Agreement

Comment: A number of guaranty agency representatives commented on the Secretary's proposal to modify the regulations to reflect his view that guaranty agencies may retain collection costs totaling up to 18.5% of the outstanding principal and accrued interest of a defaulted FFEL Program loan that is repaid by a consolidation loan if the collection costs are included in the payoff amount certified by the guaranty agency. These commenters argued that the HEA allows the guaranty agencies to retain 27 percent of payments received from borrowers on defaulted loans including payoffs provided through consolidation. They also argued that the agency needs to retain these funds to pay certain costs in connection with a consolidation loan. The agency representatives suggested that their view is consistent with Congressional intent as shown by budget ''scoring'' of a budget reconciliation bill in 1996 that included a provision that the agencies believe supports their position.

Other commenters, including school organizations and borrower advocates, supported the proposed regulation limiting collection costs and the retention by guaranty agencies. These commenters noted that the addition of collection costs can be a disincentive for a borrower to consolidate a loan—thus eliminating an important tool to reduce defaults. These commenters also urged the Department to consider eliminating the authority for the guaranty agencies to add any collection costs to a defaulted loan that is consolidated.

Discussion: The comments of the guaranty agency representatives are based on the view that a consolidation loan payoff amount is a ''payment'' for purposes of section 428(c)(6) of the HEA. The Secretary, however, believes that the agencies' interpretation is contrary to the words and intent of the HEA. In defining the ''Secretary's equitable share'' for purposes of the guaranty agency's retention of collections, the HEA specifically refers to ''the Secretary's equitable share of payments made by the borrower''. A consolidation loan payoff amount is not paid by the borrower but instead is paid by a third party (the consolidating lender) and does not reduce the borrower's obligation. Thus, a loan consolidation is not covered by section 428(c)(6).

In addition, in interpreting the HEA, it is appropriate to look at both the specific statutory language and at the language and design of the entire statute. See *Connecticut Student Loan Foundation* v. *Riley,* Case No 3:93CV02570 (JBA) (D.Conn., Oct. 31, 1996). The guaranty agencies' interpretation is also inconsistent with other provisions of the HEA. Under the agencies' approach, a borrower who consolidated a defaulted loan would not be responsible for the collection costs on that loan. Instead, the taxpayer would pick up those costs by allowing the agency to retain a certain portion of the consolidation loan payoff amount. This is contrary to section 484A(b) of the HEA. At the same time, under this approach, the agencies would be allowed to retain an amount far in excess of their actual collection costs. Numerous audits of guaranty agencies show that the guaranty agencies' contracts with collection agencies frequently provided for payments to the collectors of far less than 27 percent when a defaulted loan is included in a consolidation loan. The agencies' comments on the NPRM did not address this issue or provide any supporting information for their claim that they need a greater retention to pay additional costs. Allowing the guaranty agencies to retain an amount far in excess of the amount they have established as the cost of collecting on the loan (in addition to the reinsurance payment the agency received) would provide an unnecessary and inappropriate windfall for the agencies. Finally, the Secretary notes that the agencies' claim that their view is consistent with Congressional intent based on the budget ''scoring'' of a provision in a bill that was ultimately vetoed is unpersuasive.

The Secretary appreciates the concerns of the school and borrower advocates that the addition of collection costs reduces the value of the option of consolidation. The Secretary is continuing to evaluate how to address this issue while protecting the Federal fiscal interest.

Changes: None

Section 682.404(a)(2)(ii)—Federal Reinsurance Agreement Deadline for Preclaims Collection Assistance

Comment: The majority of commenters representing guaranty agencies, lenders, lender servicers, and secondary markets supported the Secretary's effort to promote standardization and simplification, but objected to the proposal that guaranty agencies be required to offer preclaims collection assistance to lenders on delinquent accounts no later than the 75th day of delinquency. These commenters recommended that the deadline be no later than the 90th day of delinquency. Two other guaranty agency commenters strongly objected to the Department establishing any deadline for beginning preclaims assistance on the grounds that many agencies have developed their own default prevention efforts based on portfolio characteristics and what has been shown to work best for their agencies. These commenters believe that agencies should be allowed to continue establishing the beginning date for preclaims assistance. One of these two commenters suggested that if, as the Secretary suggested in the preamble to the NPRM, some agencies have not provided preclaims assistance on a timely basis, the Department should address the problem with those guarantors. The commenters representing school and financial aid officer associations supported the Secretary's proposal, one stating that early intervention can prevent many defaults and the other that this change will ensure that delinquent borrowers are treated in a similar manner regardless of the guaranty agency performing the preclaims activities.

Many commenters indicated that starting preclaims assistance earlier than the 90th day may confuse borrowers and cited studies conducted by several major guaranty agencies showing that about one-third of borrower delinquencies are resolved between the 60th and 90th day. They also cited a similar study conducted by a major lender that showed a 41 percent default aversion rate by the lender during this period. These commenters believe that a ''no later than 90 days'' time frame will afford borrowers with the opportunity to fulfill their commitments to their loan holders and servicers without intervention by guarantors. They also believe such an approach will avoid unnecessary lender and guaranty agency costs.

Discussion: The Secretary continues to believe that early preclaims intervention by a guaranty agency is

critical to default aversion, but agrees with the commenters that how early that intervention takes place may appropriately depend upon a number of factors, such as those mentioned by the commenters. The Secretary has decided that until further discussions with the loan industry and review of servicing data can take place, agencies should be given some flexibility in beginning their preclaims collection activities. However, the Secretary continues to believe that it is appropriate to establish an outer deadline for a guaranty agency to offer preclaims assistance to lenders. After consideration of the comments, the Secretary has decided to accept the suggestion that the 90th day of delinquency is an appropriate deadline.

Changes: The regulations have been amended to require guaranty agencies to offer preclaims assistance to lenders no later than the 90th day of delinquency.

Information and Counseling Requirements

Comment: Several commenters noted that the use of the phrase ''consolidate the defaulted loan'' in the proposal to require guarantors to provide counseling and written consumer information to a delinquent borrower no later than the 100th day of delinquency was not correct within the context of preclaims assistance and recommended that the reference should be to ''delinquent'' rather than ''defaulted'' loan.

Discussion: The Secretary agrees that the use of the word ''defaulted'' is incorrect in the context of preclaims assistance contacts with delinquent borrowers.

Changes: The word ''delinquent'' is substituted for ''defaulted'' in the provision.

Comment: All of the guaranty agency, lender and loan servicer, and secondary market commenters agreed with the Secretary that there should be a consistent time period during the preclaims assistance process for the guaranty agency to provide specific information to the borrower on consolidation and other default prevention options. Because most of these same commenters recommended that guaranty agencies be given flexibility, up to the 90th day of delinquency, to begin the preclaims effort, they recommended that a consistent standard be achieved by requiring that the information be provided to the borrower no later than the 30th day following the agency's receipt of the preclaims assistance request from the lender rather than by the 100th day of delinquency as the Secretary proposed. These commenters indicated that they believed that this time frame will allow a guaranty agency the ability to perform preclaims activities in an orderly and logical sequence even if the lender's request is late. They also pointed out that under the Secretary's proposal, if a lender requests preclaims assistance as early as the 60th day of delinquency, the agency has up to 40 days to provide the required information, whereas if a lender requests preclaims assistance at the 90th day of delinquency, the agency would have only 10 days to provide the information.

Discussion: The Secretary agrees that, in light of the change in the guaranty agency's deadline for offering preclaims assistance, the 100th day of delinquency is no longer an appropriate deadline for requiring the guaranty agency to provide the required consumer information and counseling. The Secretary also agrees with commenters that there should be a consistent time period for agencies to provide this important consumer information. However, the Secretary believes that it is vital that this information be provided to the borrower through the preclaims assistance process as soon as possible after the lender requests preclaims assistance. The borrower should have every opportunity to take steps to remedy the delinquency before the agency undertakes more intensive supplemental preclaims efforts. Under the commenters' proposal that the information be provided to the borrower no later than the 30th day following the agency's receipt of the lender's request for preclaims collection assistance, this goal cannot be met. For example, if an agency offers preclaims assistance on the 90th day of delinquency and the lender uses the full 10 days provided in 34 CFR 682.411(h) to request assistance, the borrower might not receive the information until the 130th day of delinquency, which is well within the supplemental preclaims period. The Secretary believes that this result does not serve the borrowers. To avoid this situation, the Secretary has decided to require the guaranty agency to provide the consumer information and counseling no later than 10 working days after it receives the lender's request for preclaims assistance.

Changes: The regulations have been revised to require a guaranty agency to provide counseling and consumer information to the borrower no later than 10 working days after receiving a lender's request for preclaims assistance.

Comment: The majority of commenters supported providing consumer information on default aversion options to delinquent borrowers as part of preclaims assistance activities. One borrower supported the proposal and noted that information on consolidation was not readily available to him when he encountered difficulties in being able to repay his loan and that he almost defaulted because his lender did not participate in the Consolidation program. However, an overwhelming number of commenters strongly objected to what they perceived as a proposal that the guaranty agency provide consumer information on only the consolidation loan option. The commenters indicated that they believe that loan consolidation is not always the best option for many borrowers because of the potential loss of benefits on the underlying loans being consolidated. They also pointed out that not all borrowers may be eligible for consolidation. All the commenters recommended that the consumer information provided to the borrower include all of the options available to resolve the delinquency, including deferment, forbearance, and the opportunity for an income-sensitive repayment schedule. One commenter recommended that the Department provide the guaranty agencies with a prepared information piece that outlines all the default aversion options and borrower profiles describing which borrowers might benefit from which option.

Discussion: The Secretary agrees with the commenters that the information provided to the borrower should include all default aversion options available to the borrower, not just FFEL and Direct Loan Consolidation. The Secretary's proposal was intended to ensure that consolidation was included as an option in preclaims counseling and information, but it was not intended to suggest that information on other options should be withheld. The borrower's comment supports the Secretary's belief that information on consolidation has not been readily made available to delinquent borrowers. The Department agrees with the suggestion that a prepared information piece providing an overview of available options with borrower profiles would be useful.

Changes: The regulations are amended to clarify that the information provided to the borrower must include all options available to avoid default, including FFEL and Direct Loan Consolidation.

Comment: Many loan industry (guaranty agency, lender, and lender servicer) commenters recommended that the Secretary modify the regulations to allow agencies to provide

the required consumer information in formats other than written ones, such as video and e-mail. The commenters believe that the regulations should not preclude the use of more innovative mediums for providing this information. These same commenters questioned the advisability of requiring both written information and counseling, suggesting that providing both may cause borrower confusion. The commenters also requested clarification as to whether the written consumer information could be provided as part of the letter that is one of the three required preclaims activities and whether there are any situations, such as an invalid address or when the borrower has requested that the agency cease all collection activities, in which the agency would be relieved of the requirement to provide this information.

Discussion: The Secretary agrees that the regulations should not prevent a guaranty agency from providing borrowers with required counseling and consumer information in formats other than written letters. The Department is primarily concerned with ensuring that the borrower receives the information in an appropriate manner. Thus, an agency may use different methods of providing the information to the borrower as long as the agency can show that the delinquent borrower received the information. The Secretary also agrees that this information may be provided as part of a preclaims letter, provided the default aversion options are clearly and prominently presented and not buried in the text of the letter. The Secretary does not agree that reinforcing the written consumer information with counseling will confuse borrowers. The Secretary believes that it is important for the agency to follow up with the borrower to determine that the borrower received and understood the information, to answer any questions the borrower may have about the available options, especially the loan consolidation programs, and to encourage the borrower to act on one of the options to halt the increasing delinquency. The Secretary expects an agency to provide this information to the extent that a valid address or telephone number is available for the borrower.

Changes: The regulations have been modified to specify that an agency may provide written consumer information on default aversion options as part of the required preclaims letter and/or in other written materials or other formats as a separate information piece.

Comment: Loan industry commenters expressed concern about the provision that specifies that an agency's failure to provide the required consumer information and counseling constitutes a violation of the guaranty agency's obligation to perform due diligence in collecting the loan. The commenters objected to what they viewed as the imposition of punitive sanctions on a loan-by-loan basis and requested that the Department withhold assessing penalties for noncompliance with this provision until the major due diligence reform effort previously announced by the Department is started. These commenters also requested clarification that a lender would not be harmed by an agency's failure to comply with this requirement and that any penalties would be paid out of an agency's reserve fund and not passed along to a lender or lender servicer.

Discussion: The Secretary understands that the use of the phrase ''servicing error'' in the preamble and the reference in the regulations to ''due diligence in collecting'' may have confused readers because common usage in the FFEL program has made a distinction between these terms. The Secretary did not intend to make such a distinction by use of these differing terms. The Secretary agrees with commenters that lenders should not be penalized for a guaranty agency's violations in this area. To clarify this, the Secretary has decided to relocate this provision.

Changes: The statement citing violations of preclaims assistance requirements as a due diligence violation of the agency has been relocated to 34 CFR 682.406(a)(12) as a condition of reinsurance.

Section 682.404(f)—Application of Borrower Payments

Comment: Many loan industry commenters agreed that only an appropriate amount from each borrower payment on a defaulted loan should be applied to collection costs, but objected to the proposed language that would prohibit the up-front assessment of collection costs after default claim payment and require that collection costs be assessed on each payment received. The commenters indicated that many guarantor systems are programmed currently to calculate up-front collection costs according to the limits established in § 682.410(b)(2) and would require significant changes to make a per payment assessment. These commenters stated that, at the very least, retroactive recalculation of collection costs should not be required except on accounts on which the agency had not previously assessed fees. In the commenters' view, such reassessment on an account on which a borrower has been making payments may increase the percentage of collection costs assessed as well as increase the total amount paid.

A few guaranty agency commenters strongly objected to any change to this provision of the regulations because they believe that the application of borrower payments as proposed is not in the best interest of the borrower and will require the borrower to pay more interest over the life of the loan because principal is reduced more slowly. These commenters believe that collection costs are a collection tool to be used by the agency and that the proposed regulation weakens this effective tool. One of these commenters also stated that he believes that this proposal would eliminate an agency's ability to compromise the debt. Some legal advocates who represent borrowers also strongly objected to the proposed change, stating that this approach will be counterproductive and will discourage defaulted borrowers from continuing to make payments because they will pay over long periods of time and not see their principal and interest diminish appreciably. The advocates recommended that the current regulations in this area be retained. A school association commenter also objected to the proposal and recommended that agencies be required to apply payments to principal and interest first, then collection and late charges. The commenter believes that the objective should be repaying the loan, not creating additional financial hardship for the borrower.

Discussion: The Secretary understands that some commenters would prefer that defaulted borrowers not be discouraged from repaying on a defaulted loan by having to pay collection costs. However, section 484A of the Higher Education Act requires that these borrowers, rather than the taxpayers, bear reasonable costs of collection. The current regulations giving the guaranty agency the option of determining how payments are to be applied has led in some instances to the borrower paying few if any collection costs and the regulations do not comply with the Federal Claims Collection Standards. Therefore, the Secretary does not believe that retaining the current requirements, as suggested by many commenters, is an option. The Secretary does not agree that this change prevents an agency from compromising a portion of the collection costs if a borrower makes a lump sum payment to satisfy the debt.

The loan industry commenters are correct that the proposed change precludes agencies from continuing to assess collection costs upfront at a time when the agency has not yet incurred

those costs. The Secretary notes that the borrower is not legally obligated to pay costs which have not been incurred. This regulatory change is intended to require the guaranty agencies to charge only those costs that have been incurred and to prohibit the upfront loading of collection costs on a borrower's account because it discourages repayment and does not reflect the agencies' actual collection expenses. In its own collection efforts, the Department calculates and displays in its billing statements the projected contingent fee charges that will be incurred and assessed against the borrower if the full amount of principal and interest owed is not immediately repaid. The Department incurs a contingent fee cost only as the borrower repays and then passes that cost on to the borrower as it is incurred on a payment-by-payment basis. The Department does not assess costs to the borrower it has not incurred and attempts to make this distinction clear in its notices to borrowers.

The Secretary understands that some agencies may be required to make significant systems changes to inform borrowers clearly that they will be assessed collection costs on a per payment basis. Because of the time and complexity involved in making the necessary systems changes, the Secretary agrees that a delayed effective date for implementation of the regulations is appropriate as reflected in the effective date section of this document. The Secretary notes, however, that there has never been a legal basis for an agency to charge collection costs it has not incurred to a borrower and the delayed effective date is not intended to justify failure to conform to the law.

Changes: No changes have been made to the regulations. However, the Secretary has provided a delayed effective date for implementation of this provision of the regulations.

Comment: In response to the Secretary's solicitation on whether a guaranty agency should be allowed to apply borrower payments to incidental charges, after collection costs, rather that only after all principal and interest is satisfied, loan industry commenters overwhelmingly recommended that this decision be the option of the guarantor. They believe guarantors should be allowed to apply payments to incidental charges, such as late charges and court fees, when they are assessed, and as the agency deems appropriate. Some legal advocates for borrowers recommended that the current requirements, which provide that payments be applied to these costs only after the repayment of all principal and interest, be retained.

Discussion: The Secretary has decided that, consistent with 4 CFR Chapter II, section 102.13(f) of the Federal Claims Collection standards, the borrower's payment must be applied to incidental charges (which the Secretary understands will be nominal amounts, such as late charges) after collection costs are paid and before the payment is applied to accrued interest and outstanding principal.

Changes: The regulations have been revised to require that borrower payments on a defaulted loan be applied to any incidental charges after the appropriate amount of collection costs is paid and before the payment is applied to accrued interest and outstanding principal.

Comment: Loan industry commenters proposed that the phrase ''reinsured interest'' in the current regulations be changed to ''accrued interest'' because the borrower owes all accrued interest whether or not the agency paid the lender insurance on the interest or the agency filed for reinsurance with the Secretary. The commenters pointed out that interest that accrues after the lender's claim is paid is not reinsured.

Discussion: The Secretary agrees with the commenters that the regulations should reference accrued interest in this provision.

Changes: The regulations have been revised to provide that borrower payments are applied to ''accrued'' interest rather than to ''reinsured'' interest.

Comment: One commenter pointed out that § 682.404(f) fails to identify that the payments being described are being applied to a defaulted loan and recommends a change to reflect this.

Discussion: The Secretary agrees with the commenter.

Changes: The regulations have been modified to refer to a defaulted loan.

Section 682.410(b)(2)—Assessment of Collection Charges

Comment: An overwhelming number of commenters objected to the proposal that would require a guaranty agency to assess a borrower in default the collection costs that the same borrower would be charged if the loan was held by the Department and recommended that the current regulatory standard be retained. Loan industry commenters, although appreciating the Secretary's goal of standardization, believe that the flat rate proposed in the NPRM is not reasonable if it bears no relation to the actual costs incurred in the collection process. These commenters believe a flat rate is inconsistent with section 428(c)(6)(B)(i) of the HEA which states that collection costs are those costs incurred by a guaranty agency in relation to collecting on defaulted loans. Finally, loan industry commenters contended that fair treatment of borrowers is preferable to uniform treatment if the result would be that borrowers would be assessed more than they otherwise would be charged. They believe a flat rate assessment will also prevent an agency from continuing to compromise collection costs when it deems it appropriate.

Some school associations supported the Secretary's proposal to mandate a maximum amount of collection costs that agencies would be authorized to assess, but strongly recommended that guaranty agencies have the flexibility to assess less than the flat rate when the actual cost is less.

Borrower representatives strongly opposed the Secretary's proposal on the grounds that the imposition of uniform collection rates is not beneficial to borrowers if uniformity means higher collection fees. They recommended that reasonable collection costs be defined as the lesser of the percent limitation in the borrower's promissory note or other repayment agreement or the guarantor's actual costs of collection.

Discussion: After further consideration, the Secretary agrees with the commenters that the assessment of a uniform rate may not be the fairest approach to assessing collection costs, and could prove counterproductive if it creates a disincentive to borrowers continuing to make payments on defaulted loans. In regard to the borrower representatives' recommendation to define reasonable collection costs by referencing the borrower's promissory note, the Secretary notes that the common promissory notes approved by the Secretary do not include any such limitation and may not be changed to provide for one.

Changes: The Secretary has decided to retain current regulations governing the maximum collection costs that may be assessed a defaulted borrower, except specifically to note that such costs are subject to limitations in the borrower's promissory note, if any.

Section 682.410(b)(6)(vii)(A)—Collection Efforts on Defaulted Loans

Comment: Loan industry commenters recommended that the Secretary withdraw the proposed change to post-default collections that would require guaranty agencies to undertake ''administrative wage garnishment'' no later than the 225th day of a borrower's delinquency because it was unclear how that proposal related to the entire text of paragraph (vii) of the current rule that

addresses guaranty agency collection efforts. The commenters noted that the term administrative wage garnishment did not appear in the text of the regulations, but that they understood that the Department's intent was to require the agencies to use administrative wage garnishment exclusively. With that understanding, the commenters strongly objected to the loss of the guaranty agency's option to undertake judicial wage garnishment which they claimed was an efficient and cost-effective means to satisfy the debt in some states. They strongly recommended that agencies be allowed to continue to use judicial wage garnishment as a collection tool and to determine whether administrative wage garnishment or judicial wage garnishment is the most appropriate collection tool in particular cases. Borrower representatives indicated that they believe that the proposal to require administrative wage garnishment may be unworkable and contrary to the borrower's best interest. These commenters believe that difficulties in obtaining accurate employment data through state labor or unemployment insurance departments may result in a high volume of nonproductive and harassing wage garnishment attempts, leading to increased legal challenges to garnishment. They believe that litigation affords a borrower with more due process protection and recommend that the Secretary withdraw the proposal.

Discussion: The Secretary believes that program experience has shown that administrative wage garnishment is a far more efficient and cost-effective collection tool than across-the-board litigation of all defaulted accounts. In regard to the loan industry comments about the alleged benefits features of judicial wage garnishment, the Secretary notes that the administrative wage garnishment authority was added to the HEA only after attempts to promote judicial wage garnishment by guaranty agencies proved ineffective. The guaranty agencies have presented no significant evidence of increased collections through the judicial wage garnishment process to justify the significant expense and complications created by that process. The Secretary also believes that the notice and opportunity for a hearing provisions in the regulations governing administrative wage garnishment afford a defaulted borrower adequate due process and an opportunity to contest the debt or enter into a repayment agreement on the loan with the guaranty agency and avoid the problems identified by the borrower commenters. The Secretary notes that this discussion is not intended to preclude a guaranty agency's use of a state administrative wage garnishment process that would provide similar benefits and protections to the government and the borrower as the HEA. The Secretary invites any agency that believes it has such authority to discuss the use of such authority with the Secretary. The Secretary also notes that this regulation is not intended to prohibit an agency from using state tax refund offset authority that may be available.

The Secretary does agree with the commenters that conforming changes are necessary to § 682.410(b)(6)(vii) and (b)(7) to clarify the use of wage garnishment within the greater context of the 181–545 day due diligence period and has made appropriate changes to these regulations. The Secretary notes that he will review these changes further during the planned consideration of guaranty agency due diligence requirements next year.

Changes: Conforming changes have been made to clarify this requirement within the context of the other provisions of the 181 to 545-day period specified in the regulations. References to required collection activities at the 545th day of delinquency have been deleted from the regulations.

Comment: Guaranty agency commenters overwhelmingly disagreed with the proposal that defaulted borrower accounts be assigned to the Department for litigation by the federal government if the borrower has no income that could be attached through wage garnishment, but has assets which could be attached through a court order. The commenters believe that the agencies should be permitted to choose to litigate or assign the account to the Department. They believe that agencies have the resources and procedures already in place to determine the most appropriate and cost-effective method of recovery and that assignment to the Department will not increase collections.

Discussion: The Secretary disagrees with the commenters. It is the Secretary's experience that the guaranty agencies are frequently inconsistent in pursuing and enforcing judgments.

Moreover, the process for transferring these judgments when a loan is assigned to the Secretary or transferred to another agency when the original agency closes can be complex and confusing for the agencies, the Secretary and the borrower. Thus the Secretary believes that centralized litigation by the federal government is the most cost-effective means of collecting these accounts. The Secretary believes that the number of defaulted accounts where the borrower has no income to be garnished but assets which could be attached will not be an overwhelming number and is convinced that the federal government has sufficient resources to litigate these accounts efficiently.

The Secretary does not intend that guaranty agencies immediately cease collection activity on judgments on which they are collecting. It is the Secretary's intention to eliminate the need for guaranty agency litigation on future defaults. However, the Secretary believes that guaranty agencies should continue to collect on current paying judgments. To avoid confusion, therefore, the Secretary has decided not to delete all references to litigation in the current regulation. The Secretary will make the necessary technical changes to the regulations at a later date.

Changes: None.

Section 682.411—Due Diligence By Lenders in the Collection of Guaranty Agency Loans

Comment: Many loan industry commenters strongly supported the Secretary's effort to change the timing of the first delinquency notice required in § 682.411(c) of the regulations and the resulting change in the timing of the subsequent due diligence period in § 682.411(d), but recommended that the 1- to 15-day period be extended to a 1–20-day period. The commenters indicated that they believe that borrowers assume that a 15-day grace period, similar to that available on many consumer loans, is available on their student loans. They believe that the additional five days they are requesting would allow borrowers to mail payments within 15 days of the due date without adverse consequences. The commenters believe that the use of the 20-day standard will eliminate unnecessary collection letters from being generated. Another commenter recommended that either a 15-day period or a 20-day period be used, depending upon the lender's policy for reporting delinquencies to credit bureaus. The majority of loan industry commenters urged the Secretary to allow lenders to implement the change in the time period for delinquent notices or collection letters ''no later than July 1, 1997.''

Discussion: The Secretary believes that because a student loan may be a borrower's first consumer loan experience, lenders must exercise greater diligence than they might on other consumer loans in order to monitor borrower delinquency and take proactive steps to ensure that a borrower establishes a successful repayment

pattern. The Secretary believes that adopting the 15-day period for the first notice of delinquency will eliminate the possibility of unnecessary collection notices. In response to the request for early implementation of this change, the Secretary notes that, under section 482(c) of the HEA, this change cannot be effective until July 1, 1997.

Changes: A conforming change to reference the 15-day standard for generating the first delinquency notice has been made in § 682.202(f)(2) of the regulations.

Comment: Many loan industry commenters disagreed with the proposal that the first notice of delinquency required by § 682.411(c) provide the borrower with information on loan consolidation, forbearance, and other available options to avoid default. The commenters point out that the borrower's initial delinquency is not necessarily a sign of either financial difficulty in making scheduled payments or of impending default. They believe that the initial notice should simply remind the borrower of the delinquency and that he or she should call the lender or lender servicer if he or she is having difficulty making scheduled payments. They also point out that a first notice of delinquency is generally issued in a billing statement format that is not intended to alienate or intimidate the borrower and that space for providing extensive information is limited.

Many of these same commenters also objected to adding the additional notice to subsequent collection letters required under § 682.411(d). The commenters argued that lenders and lender servicers should be allowed to insert a notice of their own design that they believe will elicit the best response from the borrower and further recommended that the specific references in the notice to wage garnishment, tax offset, and litigation be replaced with a more generic reference to the lender taking ''other actions as authorized by law.'' The commenters believe that many borrowers do not understand what these terms mean and that the lender should be allowed to explain these legal actions in simple language that borrowers will understand. They also indicated that a listing of specific consequences may suggest to the borrower that this list supersedes any right the guarantor or the Secretary has to pursue collection as provided for in the borrower's promissory note.

Discussion: The Secretary disagrees with commenters that informing the borrower that there are various options available to assist the borrower if he or she is having difficulty making scheduled payments is inappropriate in the first notice of delinquency. Given the current due diligence requirements for issuing second and subsequent collection letters, there will be a significant delay before the next collection letter is issued in which this information could be provided. The Secretary notes that he did not intend to require that the first notice of delinquency contain *detailed* information on loan consolidation, forbearance, deferments, and other default aversion options. This sentence was placed in paragraph (c) in error and was intended instead to be included in the 16–180 day delinquency collection timeframe. The Secretary recognizes that not all borrowers may be experiencing difficulties at this stage and that the billing format generally used to issue the first notice has limited space. Therefore, the Secretary has decided that it is sufficient to include on the first notice a prominent statement, which includes the name and a telephone number of a contact person, and that informs the borrower that other options are available if he or she is experiencing difficulties making scheduled payments.

In regard to the later collection letters, however, the Secretary believes that providing information on default aversion options and the proceedings that may be instituted against the borrower are even more critical. The Secretary believes that borrowers are capable of understanding the required notice related to tax offset, wage garnishment, and litigation by the federal government and notes that nothing prevents a lender from explaining these terms in simpler language after providing the notice if the lender believes it is necessary.

Changes: Section 682.411(c) has been modified to require the lender to include a prominent message in the first delinquency notice briefly mentioning that various forms of assistance are available to borrowers experiencing repayment difficulties and providing a telephone contact number for further information. Section 682.411(d) has been modified to incorporate the more complete information disclosure originally proposed in § 682.411(c).

Section 682.413—Remedial Actions

Comment: The majority of guaranty agency commenters stated that the Secretary should only exercise the remedial action of loan assignment in circumstances involving repetitive violations and consistent patterns of noncompliance, not isolated or occasional violations that do not materially impact the collectability of the loan. The commenters also stated that the regulations should define the circumstances under which the assignment option will be used rather than the loss of reinsurance option and provide that it is the guarantor's choice as to which option will be used. These same commenters recommended that guaranty agencies be provided with a ''curing'' process for due diligence violations comparable to that provided for lenders and an appeal process related to any actions taken by the Secretary under this section.

Discussion: The option of assignment is intended as additional discretionary authority that will allow the Secretary to address guaranty agency violations of any of the fiscal, administrative and enforcement requirements of § 682.410 in a manner that best serves the interests of the FFEL program. The Secretary has the responsibility to determine the appropriate sanction and he does not agree that the guaranty agency should be able to choose how its violation should be addressed. The Secretary will determine the appropriate action on a case-by-case basis. Therefore, he also declines to incorporate into the regulations a list of circumstances under which he would decide to use the option of mandatory assignment. The Secretary further notes that 34 CFR 682.413(d) already addresses the procedures the Secretary will follow in imposing a fine or penalties under this section of the regulations and provides guarantors with appropriate due process. The Secretary believes any discussions related to guaranty agency due diligence and proposed cures should be left to the due diligence reform effort that the Department will undertake in 1997.

Changes: None.

Comment: A number of commenters proposed various technical changes to the regulations included in the NPRM.

Discussion: The Secretary appreciates the commenters' suggestions for technical changes and agrees with many of the suggestions. However, in some cases, those suggestions go beyond the scope of this rule. Accordingly, the Secretary will incorporate those changes in a separate publication that will be issued shortly.

Changes: None.

Comment: One commenter asked the Secretary to address the issue of whether the Federal Fair Debt Collection Practices Act (FDCPA) applies to guaranty agency collection activities on defaulted loans.

Discussion: It has been the longstanding view of the Secretary and the Federal Trade Commission that the FDCPA does not apply to guaranty

agencies collecting defaulted FFEL Program loans in their own names and protecting the financial interests of their guarantee programs. The FDCPA does not apply to an entity collecting a debt it is owed. Moreover, application of the FDCPA to the guaranty agencies would potentially penalize them for compliance with the requirements in 34 CFR 682.410 and, thus, is inconsistent with the Secretary's goal of ensuring a minimum standard of collection action. The Secretary notes, however, that the FDCPA clearly applies to a collection contractor acting for the guaranty agency. Such contractors are collecting a debt owed to another and are clearly subject to the FDCPA.

Change: None.

Regulatory Flexibility Act Certification

Comment: Many commenters stated that § 682.404, requiring the guaranty agency to offer preclaims assistance no later than the 75th day of delinquency, could have a significant impact on lenders, particularly small lenders. The commenters also stated that many loans that become 60 to 90 days delinquent are ''self-cured'' through the borrower or other party providing documentation for deferment or forbearance. In addition, the commenters noted that requiring assistance from the guaranty agency earlier in the process could result in unnecessary requests for preclaims assistance and the unnecessary loading and processing of the preclaims assistance request by the guarantor.

Discussion: The Secretary agrees with the commenters and believes that it would be more advantageous for collection assistance to be made available to the lender by the guaranty agency no later than the 90th day of delinquency.

Change: The regulations have been revised to provide that preclaims assistance be made available no later than the 90th day of delinquency.

Comment: Many commenters stated that the § 682.411 provision establishing a minimum of information to be included in the letters sent by lenders to delinquent borrowers during the 1–15 days of delinquency provides too much information and reduces the clarity of the letters making the letters less effective. The commenters expressed concern that requiring additional information in the notice sent during this period could create a significant burden on lenders, since the first notice is generally a billing statement.

Discussion: The Secretary notes that it was not the Department's intent to require that the notice or collection letter sent during the 1–15 days of delinquency contain detailed information for the borrower regarding loan consolidation, forbearance and other available options to avoid default. This sentence was placed in paragraph (c) in error. This requirement should have been included in the collection timeframe of 16–180 days of delinquency. However, the Secretary does want a statement in the collection letter relating to the 1–15 day delinquency that indicates that other options are available if a borrower is having difficulty making payments. The name and telephone number of a contact person should also be included in this letter.

Change: The regulations have been amended to remove this requirement from paragraph (c) and insert it in paragraph (d). A modified statement has been added to paragraph (c).

Paperwork Reduction Act of 1995

Section 682.411 contains information collection requirements. As required by the Paperwork Reduction Act of 1995, the U.S. Department of Education has submitted a copy of this section to the Office of Management and Budget (OMB) for its review. (44 U.S.C 3504(h)). In response to the Secretary's invitation in the NPRM to comment on any potential paperwork burden associated with this regulation, the following comments were received.

Comment: Many commenters suggested that the Secretary amend § 682.411(c) to expand the length of the current timeframe that lenders will have to send the first written collection notice or collection letter to a delinquent borrower from 1–10 days (1–15 in NPRM) to 1–20 days. The commenters stated that consumer loans often offer a 15-day grace period on payment due dates. They suggested that many borrowers believe that the student loan has a similar payment grace period and may delay mailing their payment. The commenters believe that many unnecessary collection letters will be eliminated by expanding the timeframe to 20 days.

Discussion: The Secretary declines to extend the timeframe specified in the NPRM (1–15 days) to 1–20 days. The Secretary believes that the expanded timeframe in the NPRM is sufficient to eliminate the majority of unnecessary collection notices that have been generated under the current 10-day period.

Change: None.

Comment: Many commenters stated that the § 682.411 provision establishing a minimum of information to be included in the letters sent by lenders to delinquent borrowers during the 1–15 days of delinquency provides too much information and reduces the clarity of the letters making the letters less effective. The commenters expressed concern that requiring that additional information be added to the notice sent during this period could create a significant burden on lenders, since the first notice is generally a billing statement.

Discussion: The Secretary notes that it was not the Department's intent to require that the notice or collection letter sent during the 1–15 days of delinquency contain detailed information for the borrower regarding loan consolidation, forbearance and other available options to avoid default. This sentence was placed in paragraph (c) in error. This requirement should have been included in the collection timeframe for the 16–180 days of delinquency. However, the Secretary does intend that a statement in the collection letter relating to the day 1–15 delinquency indicate that other options are available if a borrower is having difficulty making payments. The name and telephone number of a contact person should also be included in this letter.

Change: The regulations have been amended to remove the statement in the NPRM from paragraph (c) and insert it in paragraph (d). A modified statement has been inserted in paragraph (c).

Assessment of Educational Impact

In the NPRM, the Secretary requested comments on whether the proposed regulations in this document would require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

Based on the response to the proposed regulations and on its own review, the Department has determined that the regulations in this document do not require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

List of Subjects in 34 CFR Part 682

Administrative practice and procedure, Colleges and universities, Education, Loan programs-education, Reporting and recordkeeping requirements, Student aid, Vocational education.

(Catalog of Federal Domestic Assistance Number 84.032, Federal Family Education Loan Program)

Dated: November 21, 1996.

Richard W. Riley,

Secretary of Education.

The Secretary amends part 682 of title 34 of the Code of Federal Regulations as follows:

PART 682—FEDERAL FAMILY EDUCATION LOAN (FFEL) PROGRAM

1. The authority citation for part 682 continues to read as follows:

Authority: 20 U.S.C. 1071 to 1087–2, unless otherwise noted.

2. Section 682.202 is amended by removing the number ''10'' from paragraph (f)(2) and adding in its place the number ''15''.

3. Section 682.401 is amended by revising paragraph (b)(27) to read as follows:

§ 682.401 Basic program agreement.

* * * * *

(b) * * *

(27) *Collection Charges and Late Fees on Defaulted FFEL loans being Consolidated.* (i) A guaranty agency may add collection costs in an amount not to exceed 18.5 percent of the outstanding principal and interest to a defaulted FFEL Program loan that is included in a Federal Consolidation loan.

(ii) When returning the proceeds from the consolidation of a defaulted loan to the Secretary, a guaranty agency may only retain the amount added to the borrower's balance pursuant to paragraph (b)(27)(i) of this section.

* * * * *

4. Section 682.404 is amended by revising paragraph (a)(2)(ii) and paragraph (f) to read as follows:

§ 682.404 Federal reinsurance agreement.

* * * * *

(a) * * *

(2) * * *

(ii) *Preclaims assistance* means collection assistance made available to the lender by the guaranty agency no later than the 90th day of delinquency. This assistance must include collection activities that are at least as forceful as the level of preclaims assistance performed by the guaranty agency as of October 16, 1990, and involves the initiation by the guaranty agency of at least 3 collection activities, one of which is a letter designed to encourage the borrower to begin or resume repayment. As part of their preclaims assistance, guaranty agencies must provide counseling and consumer information (in written or other format) to the borrower by the 10th working day after the agency receives the lender's request for preclaims assistance informing the borrower of all of the borrower's options to avoid default, including the availability of consolidating delinquent loans under the FFEL Program or the Federal Direct Consolidation Loan Program.

* * * * *

(f) *Application of borrower payments.* A payment made to a guaranty agency by a borrower on a defaulted loan must be applied first to the collection costs incurred to collect that amount and then to other incidental charges, such as late charges, then to accrued interest and then to principal.

* * * * *

5. Section 682.406 is amended by revising paragraph (a)(12) to read as follows:

§ 682.406 Conditions of reinsurance coverage.

* * * * *

(a) * * *

(12) The agency and lender complied with all other Federal requirements with respect to the loan including the payment of origination fees and compliance with all preclaims assistance requirements in § 682.404(a)(2)(ii);

* * * * *

6. Section 682.410 is amended by revising paragraphs (b)(2) and(b)(6)(vii)(A) to read as follows:

§ 682.410 Fiscal, administrative, and enforcement requirements.

* * * * *

(b) * * *

(2) *Collection charges.* Whether or not provided for in the borrower's promissory note and subject to any limitation on the amount of those costs in that note, the guaranty agency shall charge a borrower an amount equal to reasonable costs incurred by the agency in collecting a loan on which the agency has paid a default or bankruptcy claim. These costs may include, but are not limited to, all attorney's fees, collection agency charges, and court costs. Except as provided in §§ 682.401(b)(27) and 682.405(b)(1)(iv), the amount charged a borrower must equal the lesser of—

(i) The amount the same borrower would be charged for the cost of collection under the formula in 34 CFR 30.60; or

(ii) The amount the same borrower would be charged for the cost of collection if the loan was held by the U.S. Department of Education.

* * * * *

(6) * * *

(vii) After 181 days:

(A) Except as provided in paragraph (b)(6)(vii)(B) of this section, during this period but not sooner than 30 days after sending the notice described in paragraph (b)(5)(vi) of this section, the agency shall initiate proceedings to offset the borrower's state and federal income tax refunds and other payments made by the federal government to a borrower, and shall initiate administrative wage garnishment proceedings against the borrower by the 225th day. If the agency determines that the borrower has insufficient income to satisfy the debt through wage garnishment, but has assets from which the debt can be satisfied, the agency shall assign the loan to the Department. The agency must not file suit to collect a loan from a borrower unless directed to do so by the Secretary.

* * * * *

7. Section 682.411 is amended by revising paragraphs (c), (d) introductory text, (d)(1), and (d)(2) to read as follows:

§ 682.411 Due diligence by lenders in the collection of guaranty agency loans.

* * * * *

(c) *1–15 days delinquent:* Except in the case where a loan is brought into this period by a payment on the loan, expiration of an authorized deferment or forbearance period, or the lender's receipt from the drawee of a dishonored check submitted as a payment on the loan, the lender during this period shall send at least one written notice or collection letter to the borrower informing the borrower of the delinquency and urging the borrower to make payments sufficient to eliminate the delinquency. The notice or collection letter sent during this period must include, at a minimum, a lender/servicer contact and telephone number, and a prominent statement informing the borrower that assistance may be available if he or she is experiencing difficulty in making a scheduled repayment.

(d) *16–180 days delinquent (16–240 days delinquent for a loan repayable in installments less frequent than monthly):* (1) Unless exempted under paragraph (d)(4) of this section, during this period the lender shall engage in at least four diligent efforts to contact the borrower by telephone and send at least four collection letters urging the borrower to make the required payments on the loan. At least one of the diligent efforts to contact the borrower by phone must occur before, and another one must occur after, the 90th day of delinquency. The notice or collection letter sent during this period must include, at a minimum, information for the borrower regarding deferment, forbearance, income-sensitive repayment and loan consolidation and other available options to avoid default.

(2) At least two of the collection letters required under paragraph (d)(1) of this section must warn the borrower that if the loan is not paid, the lender will assign the loan to the guaranty agency that, in turn, will report the default to all national credit bureaus,

and that the agency may institute proceedings to offset the borrower's state and federal income tax refunds and other payments made by the federal government to a borrower or to garnish the borrower's wages, or assign the loan to the federal government for litigation against the borrower.

* * * * *

8. Section 682.413 is amended by redesignating paragraph (b) as paragraph (b)(1) and adding a new paragraph (b)(2) to read as follows:

§ 682.413 Remedial actions.

* * * * *

(b)(1) The Secretary requires a guaranty agency to repay reinsurance payments received on a loan if the lender, third-party servicer, if applicable, or the agency fails to meet the requirements of § 682.406(a).

(2) The Secretary may require a guaranty agency to repay reinsurance payments received on a loan or to assign FFEL loans to the Department if the agency fails to meet the requirements of § 682.410.

* * * * *

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