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Part VII

Department of Education

34 CFR Part 674

Federal Perkins Loan Program; Final Rule

DEPARTMENT OF EDUCATION

34 CFR Part 674

RIN 1845–AA05

Federal Perkins Loan Program

AGENCY: Department of Education.

ACTION: Final regulations.

SUMMARY: The Secretary amends the Federal Perkins Loan Program regulations. The regulations implement changes to the Higher Education Act of 1965, as amended (HEA), resulting from the Higher Education Amendments of 1998 (1998 Amendments). These final regulations reflect the provisions of the 1998 Amendments that affect the institutions that participate in, and borrowers who have loans made under, the Federal Perkins Loan Program. These final regulations expand borrower benefits under the Federal Perkins Loan program by increasing loan limits, expanding borrower eligibility for deferments and cancellations, establishing a loan rehabilitation program for borrowers in default on their Federal Perkins Loans, establishing an incentive repayment program, and providing a closed school discharge.

DATES: *Effective Date:* These regulations are effective July 1, 2000.

Implementation Date: The Secretary has determined, in accordance with section 482(c)(2)(A) of the HEA, that institutions that participate in the Federal Perkins Loan Program may, at their discretion, choose to implement the provisions of §§ 674.2, 674.5(c), 674.9, 674.16, 674.33(f), 674.41, 674.42, and 674.45 in these final regulations, on or after October 28, 1999. For further information see ''Implementation Date of These Regulations'' under the **SUPPLEMENTARY INFORMATION:** Section of this preamble.

FOR FURTHER INFORMATION CONTACT: Gail McLarnon, Program Specialist, Program Development Division, Office of Student Financial Assistance, 400 Maryland Avenue, SW, ROB–3, Room 3045, Washington, D.C. 20202–5449. Telephone: (202) 708–8242. If you use a telecommunications device for the deaf (TDD), you may call the Federal Information Relay Service (FIRS) at 1–800–877–8339.

Individuals with disabilities may obtain this document in an alternative format (*e.g.*, Braille, large print, audiotape, or computer diskette) on request to the contact person listed in the preceding paragraph.

SUPPLEMENTARY INFORMATION: These regulations implement the Higher Education Amendments of 1998 (Pub. L. 105–244), enacted October 7, 1998.

On July 29, 1999, the Secretary published a notice of proposed rulemaking (NPRM) for the Federal Perkins Loan Program regulations in the **Federal Register** (64 FR 41231). In the preamble to the NPRM, the Secretary discussed the following major proposed changes:

Amending § 674.2 to add a definition of the term ''satisfactory repayment arrangements'' (page 41233).

Amending § 674.5 to establish, effective with award year 2000–2001, a default penalty of zero Federal Capital Contribution for institutions with a cohort default rate of 25 percent or higher and a new default penalty that terminates the eligibility of an institution to participate in the Federal Perkins Loan Program if the institution has a cohort default rate of 50 percent or higher for the three most recent years for which data are available. The Secretary also discussed amending § 674.5 to allow an institution to exclude certain loans from its cohort default rate calculation (pages 41233–41234).

Removing and reserving § 674.7 in accordance with the elimination of the Expanded Lending Option.

Amending § 674.9 to authorize the use of the same criteria that remove a borrower from an institution's cohort default rate to re-establish a borrower's eligibility for additional Federal Perkins Loans (pages 41234–41235).

Amending § 674.12 to increase annual maximum loan amounts and increase the aggregate maximum loan amounts allowable for an eligible student to levels formerly authorized under the Expanded Lending Option (page 41235).

Amending §§ 674.16, 674.31, and 674.45 to update and clarify credit bureau reporting requirements with which an institution must comply (page 41235 and page 41238).

Amending § 674.31 to exclude from a borrower's initial grace period any period, not to exceed three years, during which a borrower who is a member of an Armed Forces reserve component is called or ordered to active duty (page 41235).

Amending § 674.33 to authorize institutions to establish an incentive repayment program to reduce defaults and replenish their Federal Perkins Loan revolving fund. Also amending § 674.33 to establish a closed school discharge for Federal Perkins Loan borrowers who are unable to complete their programs of study due to an institution's closure (pages 41235–41236).

Amending § 674.34 to extend the deferment benefits in this section to all borrowers regardless of the terms of the borrower's promissory note or when the loan was made (page 41236).

Amending § 674.39 to require institutions to establish a loan rehabilitation program for all defaulted Federal Perkins Loan borrowers (pages 41236–41237).

Amending §§ 674.41, 674.42 and 674.45 to require that institutions participating in the Federal Perkins Loan Program provide borrowers with information on the availability of the Student Loan Ombudsman's office (pages 41237–41238).

Amending § 674.42 to facilitate the use of electronic means in providing personalized exit counseling and make exit counseling requirements in the Federal Perkins Loan Program consistent with those in the Federal Direct Loan and the Federal Family Education Loan Programs (pages 41237–41238).

Amending § 674.47 to authorize an institution, until July 1, 2002, to charge its revolving fund for any collection costs assessed on a rehabilitated loan that are in excess of the 24 percent maximum limit that may be passed along to the borrower (page 41238).

Amending § 674.49 to reflect changes made to section 523(a)(8) of the Bankruptcy Code that eliminate a borrower's ability to have a student loan discharged on the ground that the loan has been in repayment for seven years or more (page 41238).

Amending §§ 674.53, 674.56, 674.57, 674.58, and 674.60 to extend the cancellation benefits authorized by these sections, for eligible service performed on or after October 7, 1998, to all borrowers with a loan made under the Federal Perkins Loan program regardless of the date the loan was made or the terms of the borrower's promissory note (pages 41238–41239).

Implementation Date of These Regulations

Section 482(c) of the Higher Education Act of 1965, as amended (20 U.S.C. 1089(c)) requires that regulations affecting programs under title IV of the Act be published in final form by November 1 prior to the start of the award year in which they apply. However, that section also permits the Secretary to designate any regulation as one that an entity subject to the regulation may choose to implement earlier. If the Secretary designates a regulation for early implementation, he may specify when and under what conditions the entity may implement it. Under this authority, the Secretary has designated the following regulations for early implementation:

Section 674.2—Upon publication, institutions may implement the ''satisfactory repayment arrangements'' as defined in this provision.

Section 674.5(c)(3)—Upon publication, institutions may exclude certain loans from its cohort default rate calculation.

Section 674.9—Upon publication, institutions may use the criterion that removes a borrower from its cohort default rate to re-establish a borrower's eligibility for Perkins Loans.

Sections 674.16, 674.31 and 674.45—Upon publication, institutions may implement the credit bureau reporting requirements contained in these sections.

Section 674.33(f)—Upon publication, institutions may implement incentive repayment programs.

Sections 674.41, 674.42 and 674.45—Upon publication, institutions may provide borrowers with information on the availability of the Student Loan Ombudsman's office.

These final regulations contain changes from the NPRM that are explained in the Analysis of Comments and Changes that follow.

Analysis of Comments and Changes

The regulations in this document were developed through the use of negotiated rulemaking. Section 492 of the Higher Education Act requires that, before publishing any proposed regulations to implement programs under Title IV of the Act, the Secretary obtain public involvement in the development of the proposed regulations. After obtaining advice and recommendations, the Secretary must conduct a negotiated rulemaking process to develop the proposed regulations. All proposed regulations must conform to agreements resulting from the negotiated rulemaking process unless the Secretary reopens that process or explains any departure from the agreements to the negotiated rulemaking participants.

These regulations were published in proposed form on July 29, 1999, in conformance with the consensus of the negotiated rulemaking committee. Under the committee's protocols, consensus meant that no member of the committee dissented from the agreed-upon language. The Secretary invited comments on the proposed regulations by September 15, 1999, and several comments were received. An analysis of the comments and of the changes in the proposed regulations follows.

We discuss substantive issues under the sections of the regulations to which they pertain. Generally, we do not address technical and other minor changes—and suggested changes the law does not authorize the Secretary to make.

General Comment

Comment: We received 28 comments on the Federal Perkins Loan Program NPRM published July 29, 1999. The comments were generally supportive. However, one commenter stated that any changes made by the Secretary in the Federal Perkins Loan program final regulations that represent a substantive departure from the proposed regulations published on July 29, 1999, would be viewed as a failure to honor the consensus reached by Committee II, a violation of the good faith with which members of Committee II engaged in negotiated rulemaking and would be detrimental to future negotiations.

Discussion: The 1998 Amendments amended section 492 of the HEA to require that all Title IV proposed regulations be subject to the negotiated rulemaking process. While this change requires the Secretary to publish proposed regulations that conform to agreements resulting from a negotiated rulemaking process, the 1998 Amendments did not change the process by which final regulations are promulgated. All proposed regulations continue to be subject to a public comment period, as required by the Administrative Procedure Act, and may be changed as a result of our full and careful consideration of the comments we receive from the public on an NPRM, regardless of agreements reached on proposed regulations during the negotiated rulemaking process.

Section 674.2 Definitions

Comment: One commenter expressed the view that the proposed definition of ''satisfactory repayment arrangements,'' which requires the borrower to make six on-time, consecutive, monthly payments on a defaulted loan to re-establish Title IV HEA eligibility, should specify how an institution determines the amount of the six monthly payments the borrower must make.

Discussion: The concept of satisfactory repayment arrangements is not new to the Federal Perkins Loan Program. The Federal Perkins Loan program regulations have contained a definition of satisfactory repayment arrangements since July 1, 1995. The regulatory definition required that a defaulted borrower either repay the loan in full, or execute a new written repayment agreement and make one payment each month for six consecutive months to re-establish title IV eligibility. We disagree that the regulations should specify how an institution determines the amount of the six monthly payments the borrower must make to re-establish Title IV eligibility. However, it has been our long-standing interpretation that the institution would calculate the amount due for each of the six payments consistent with an overall payment schedule that would allow the borrower to satisfy the outstanding balance on the loan in the time remaining in the original 10-year repayment period. The new written repayment agreement facilitated this calculation.

A similar definition of satisfactory repayment arrangements was codified in law by the 1998 Amendments but does not contain the requirement that the borrower execute a new written repayment agreement when making satisfactory repayment arrangements. Regardless of that fact, it remains our interpretation that in determining the amount of the six payments a borrower must make to re-establish Title IV eligibility, an institution must calculate a payment amount consistent with a payment schedule that satisfies the total amount due on the loan within the time remaining in the original ten-year repayment period, especially absent statutory language in the 1998 Amendments that specifies that the monthly payment amount as determined by the institution be reasonable and affordable based on the borrower's total financial circumstances, as is the case in the Federal Family Education Loan (FFEL) and the William D. Ford Federal Direct Loan (Direct Loan) programs. We believe the definition of satisfactory repayment arrangements, as proposed, is the best reflection of both the statute and our long-standing interpretation of the payment amount required by a borrower.

Changes: None.

Section 674.5 Federal Perkins Loan Program cohort default rate and penalties

Comment: One commenter objected to the elimination of the graduated default penalties imposed on institutions with cohort default rates that equal or exceed 20, 25, or 30 percent or more in favor of one default penalty of zero if an institution's cohort default rate equals or exceeds 25 percent. The commenter felt that this change creates a disincentive for institutions to collect on defaulted loans.

Discussion: We appreciate the commenter's concern. However, the elimination of the graduated default penalties is required by the 1998

Amendments. The final regulations reflect this statutory change.

Changes: None.

Comment: We received several comments regarding § 674.5(a)(2), which reflects a new default penalty that terminates an institution's eligibility to participate in the Federal Perkins Loan Program if it has a cohort default rate of 50 percent or higher for the three most recent years for which data are available. One commenter recommended that we specify in regulation that an institution's cohort default rate must equal or exceed 50 percent for each of the three most recent ''consecutive'' years for which cohort default data is available. One commenter suggested that the regulation clearly state that an institution does not lose eligibility to participate in the Federal Perkins Loan program if, upon appealing a determination of ineligibility, any one of the three rates used to make that determination is found to be below 50 percent. Lastly, one commenter suggested that we clarify in the regulations that an institution loses its eligibility to participate only in the Federal Perkins Loan program if its Perkins Loan cohort default rates meet the criteria set forth in this section.

Discussion: We do not agree that the word ''consecutive'' should be added to the regulatory language. Although the regulations do not contain the word ''consecutive'' in describing the three years of cohort default data that will be used by the Secretary to make a determination of ineligibility, it is our intent to use consecutive year cohort default rate data as long as it is available. However, we believe that a requirement that we use consecutive year data could prevent the Department from making a determination of ineligibility, thus thwarting legislative intent, if either the Department or an institution is unable to calculate an institution's cohort default rate in any given year because of unforeseen circumstances. We believe that language requiring the use of an institution's cohort default rate data for each of the three most recent years for which data are available better reflects statutory intent.

As to the request for clarification regarding the appeals process and the loss of Federal Perkins Loan program eligibility, the language in § 674.5(a)(2)(i)(A) clearly states that an institution will not lose eligibility if, as a result of an appeal, any one of the three cohort rates used to make a determination of ineligibility is below 50 percent. We also note that the language in § 674.5(a)(2) also clearly states that an institution loses eligibility to participate only in the Federal Perkins Loan program.

Changes: None.

Comment: Two commenters objected to the elimination of the provision allowing an institution to exclude improperly serviced loans from its cohort default rate.

Discussion: The elimination of this provision reflects a 1998 Amendments change. This provision had the perverse effect of rewarding an institution for its, or its servicer's, lack of due diligence in servicing and collecting its Perkins Loans by allowing the institution to remove defaulted borrowers from its cohort default rate.

Changes: None.

Comment: We received several comments regarding the exclusion of borrowers from an institution's cohort default rate in § 674.5(c)(3)(i). One commenter suggested that borrowers who are considered paid-in-full as a result of a small balance write-off of their loan under § 674.47(h) be referenced in § 674.5(c)(3)(i)(C). One commenter urged us to add language allowing a school to exclude from its cohort default rate calculation all borrowers who have filed for bankruptcy and are in a stay of collection. Lastly, one commenter suggested that § 674.5(c)(3)(i)(D) be clarified to state that the borrower's status must be less than 240- or 270-days past due as a result of receiving a deferment or forbearance.

Discussion: We agree that adding a reference to borrowers whose loans have been written off under § 674.47(h) would add clarity to the regulations. However, we believe this addition is more appropriately added in § 674.5(c)(3)(ii)(D).

We disagree with the commenter who believes that all borrowers who have filed for bankruptcy and are in a stay of collections should be excluded from an institution's cohort default rate calculation. During the required stay of collection, a loan is considered to be in a suspended status. It does not continue to age, although interest continues to accrue for which the borrower is responsible. If a borrower files a bankruptcy petition that includes a defaulted Perkins loan that has not reached a 240- or 270-day past due status, the loan will retain its pre-240- or 270-day status and will be excluded from the calculation of a school's cohort rate until the bankruptcy proceeding has concluded. If the borrower includes a defaulted loan that is more than 240 or 270 days past due, the loan will retain its more than 240- or 270-day past due status and be included in the calculation of the school's cohort default rate. While we realize that an institution is unable to contact the borrower during a stay of collections, we believe that the time to work those accounts and perform the due diligence necessary to return the borrower to repayment is before the borrower becomes 240 or 270 days past due.

We do not agree that additional language specifying that a deferment or forbearance must bring the borrower to a pre-240- or 270-day status is necessary. As currently drafted, the regulations allow the institution to exclude a borrower from its cohort calculation if the borrower has ''received a deferment or forbearance based on a condition that predates the borrower reaching a 240- or 270-day past due status.'' The addition of language specifying that the deferment or forbearance has brought the borrower to a pre-240- or 270-day status is unnecessary.

Changes: A reference to loans repaid in full in accordance with § 674.47(h) has been added to § 674.5(c)(3)(ii)(D).

Comment: Several commenters objected to the proposal that payments obtained through income tax offset, wage garnishment, income or asset execution, or pursuant to a judgment should not be considered voluntary payments for the purpose of removing borrowers from an institution's cohort default rate calculation if the borrower voluntarily makes six consecutive payments or voluntarily makes all payments currently due. One commenter stated that our definition of voluntary payments is unnecessarily harsh and that all payments, regardless of how they are made, should be considered voluntary. One commenter noted that a borrower's payments are not guaranteed by a judgment—a school must still work the account to ensure that payments are made. The commenter also noted that many borrowers consider payments obtained through income tax offset to take the place of regularly scheduled payments that the borrower is already making on their own.

Discussion: We disagree that payments obtained through income tax offset, garnishment, income or asset execution, or pursuant to a judgment should be considered voluntary payments made by the borrower in order to remove a borrower whose loans are brought current or who has made six consecutive monthly payments from an institution's cohort default rate calculation. Generally, payments obtained by these methods are automatically deducted from the borrower's Federal or state tax refund, wages, or assets and the borrower has no control or choice in the payment process. We continue to believe that the initiation of court action to obtain payment on a defaulted loan represents last resort due diligence efforts on the part of the school. Payments obtained through this process would not have been obtained otherwise and cannot be considered voluntary. While we recognize that a school may have to work to collect the payments due on some judgment accounts, the required payments are nonetheless made as a result of a court order. Further, borrowers have no control over a payment applied to their defaulted loan as a result of income tax offset regardless of the fact that the borrower may already be making payments.

Changes: None.

Section 674.9 Student Eligibility

Comment: One commenter felt strongly that restoring eligibility for a Federal Perkins Loan to a borrower who meets any of the criteria that would remove him or her from an institution's cohort default rate calculation is bad public policy.

Discussion: Although the return of Federal Perkins Loan eligibility to a borrower who meets any of the criteria that remove him or her from an institution's cohort default rate calculation represents a significant departure from past policy, this is a statutory requirement enacted as part of the 1998 Amendments.

Changes: None.

Comment: One commenter strongly supported our definition of ''voluntary'' payments for the purpose of a borrower re-establishing eligibility for a Perkins Loan under this section.

Discussion: We appreciate the support of the commenter and believe it is an important condition to re-establishing eligibility.

Changes: None.

Comment: One commenter suggested that we quantify in § 674.9(i)(1) what amount a payment made ''over and above'' a payment made pursuant to a judgment must be to qualify as a voluntary payment when a school enters into a repayment agreement with the borrower on a judgment. For example, if a school has entered into an agreement with a borrower that requires $50 monthly payments to satisfy a judgment, what payment amount ''over and above'' the $50 payment would a borrower be required to make in order for his or her payment to be considered voluntary? The commenter believed that specific language would clarify the conditions a borrower must satisfy to re-establish eligibility.

Discussion: We do not believe that further clarification of the definition of voluntary payment for the purpose of re-establishing a defaulted borrower's eligibility for Federal Perkins Loans is necessary. However, a payment that is generally equal to the payment the borrower is required to make pursuant the judgment will satisfy the definition of voluntary in this section. We believe an approach that treats borrowers consistently and precludes situations in which one borrower might be required to make small payments while another borrower might be required to make large payments over and above payments made pursuant to a judgment is an important consideration when re-establishing eligibility.

In almost all cases, the terms of a judgment make the whole obligation due in full immediately, and any monthly payment arrangement that arises is solely by agreement between the borrower and the school. In some cases, the borrower and the school negotiate a repayment arrangement that is subsequently incorporated in a consent judgment. A school is free to agree to any monthly payment that it considers reasonable in such an agreed judgment or in a repayment agreement to satisfy a judgment. Therefore, we would consider payments over and above the amount owed under the judgment itself or the repayment agreement already reached to satisfy that judgment to be voluntary payments for purposes of reestablishing eligibility for new student aid. This level of payment not only represents a good faith effort on the part of the borrower to repay the debt in a manner that is neither required nor automatic, but also represents a good faith effort on the part of the school to replenish its revolving fund and responsibly administer the Federal Perkins Loan Program.

Using the above example, if a school has entered into an agreement with a borrower that requires $50 monthly payments on a judgment, we would consider a borrower that makes payments of at least $50 to be making voluntary payments.

Changes: None.

Comment: One commenter objected to having one definition of ''voluntary'' payments for re-establishing a borrower's eligibility for Federal Perkins Loans and another definition of ''voluntary'' payments in order to determine which borrowers can be excluded from an institution's cohort default rate. The commenter felt that the definition of voluntary payments should be consistent within the program regulations.

Discussion: We disagree that the definition of ''voluntary'' payments must be consistent within the program regulations. Denying a borrower access to additional student financial assistance has far more serious consequences than excluding that borrower from an institution's cohort default rate. The negotiators agreed that cutting off a borrower's access to Federal Perkins Loans had the potential to prohibit the borrower from furthering his or her education, securing employment and honoring his or her student loan obligations. The negotiators also agreed that a borrower who made payments over and above the payments made on a judgment was making a good faith effort to repay the debt and that those efforts should be recognized.

Changes: None.

Comment: One commenter felt that language restricting the definition of ''voluntary'' payments to those payments made directly by the borrower was too restrictive and that payments made on behalf of the borrower should be included as well.

Discussion: We disagree with the commenter that payments made on behalf of the borrower should be included in the definition of voluntary payments for the purpose of re-establishing a defaulted borrower's eligibility for Federal Perkins Loans. Payments made on behalf of the borrower are not payments made directly by the borrower and are payments over which the borrower has no control or choice. Payments made in this manner cannot be considered voluntary in this context.

Changes: None.

Section 674.12 Loan Maximums

Comment: All of the comments we received on the new increased loan maximums and the use of the aggregate unpaid balance in determining a borrower's eligibility for additional loans under the Federal Perkins Loan Program were supportive.

Changes: None.

Section 674.16 Making and disbursing loans

Comment: Several commenters supported language in this section that requires an institution to report to at least one national credit bureau information concerning the repayment and collection of the loan until the loan is paid in full. One commenter believed that it would be a violation of the Fair Credit Reporting Act (FCRA), however, for an institution to report on the loan until it is paid in full. Several commenters urged the Secretary to work with the Federal Trade Commission to amend the FCRA to require consumer reporting agencies to make reports containing credit information regarding the status of a borrower's Federal Perkins Loan until the loan is paid in full rather than for seven years as currently required under the FCRA.

Discussion: The general requirement that an institution report on the status of the loan to a consumer reporting agency until it is paid in full is not a new requirement under section 463 of the HEA. The 1998 Amendments did change this section of the HEA and codified many of the credit bureau reporting requirements that institutions have been required to perform for some time. We should also note that it is not now, and has not been, a violation of the FCRA for a consumer reporting agency to accept and disseminate information on a loan until the loan is paid in full; it was, prior to the 1998 Amendments to section 463, a violation of the FCRA for a consumer reporting agency to make reports for certain purposes that contain adverse information on accounts for more than seven years from the date of the adverse event reported. (The 1998 Amendments to section 463 the HEA give credit reporting agencies the option to make reports containing adverse credit information until the loan is paid in full; they do not require it.)

We will pursue opportunities to work with the Federal Trade Commission as they arise to amend the FCRA in ways that support and strengthen the repayment of Title IV student loans.

Changes: None.

Section 674.31 Promissory Note

Comment: One commenter noted that the promissory note used in the Federal Perkins Loan Program does not reflect the new provision in this section that excludes any period during which a borrower who is a member of a reserve component of the Armed Forces named in section 10101 of Title 10, United States Code is called or ordered to active duty for a period of more than 30 days from the borrower's initial grace period. The commenter requests that we clarify our intentions with regard to the development of a new Federal Perkins Loan promissory note.

Discussion: We appreciate the commenter's concern regarding the development of a promissory note that contains terms and conditions that reflect the changes made to the HEA by the 1998 Amendments. We plan to develop, as soon as possible after the publication of final regulations, an addendum to the Federal Perkins Loan program promissory note now in use that reflects the new provisions of the 1998 Amendments. The development of a new promissory note will follow. Until an addendum or a new note is developed, however, we would note that institutions must comply with the changes made to the HEA by the 1998 Amendments and that the promissory notes contained in CB–96–8 and CB–93–9 are legally valid documents.

Changes: None.

Section 674.33 Repayment

(**Note:** In this and other sections of the regulations in Part 674, the holder of a loan may be the Secretary or a non-Federal party. In these cases, requirements are written in the present indicative, rather than using the word ''must.'' However, we intend these provisions to be mandatory, regardless of who holds the loan.)

Comment: Several commenters objected to the requirement that the institution reimburse its revolving fund for any money lost to its fund that otherwise would have been paid by the borrower if the borrower had not received one of the repayment incentive discounts described in this section. The commenters felt that the Secretary should pay for incentive repayment discounts or that the revolving fund should absorb the cost of any incentive repayment that an institution may extend to its borrowers.

Discussion: The 1998 Amendments prohibit an institution from using Federal funds, including Federal funds from an institution's revolving fund, or institutional funds from the revolving fund to pay for any repayment incentive.

Changes: None.

Comment: One commenter, while supporting repayment incentives in general, believed that the regulations should allow an institution to factor in administrative savings in reimbursing its revolving fund for any money lost due to incentive repayment discounts that otherwise would have been paid by the borrower. The commenter felt that the purpose of repayment incentives is to encourage prompt repayments without increasing, and perhaps even lowering, the administrative costs to the revolving fund.

Discussion: We appreciate the commenter's desire to reflect the administrative savings generated by borrowers who pay the loan in full prior to the end of the repayment period or who make regular consecutive payments for 48 months, thereby offsetting an institution's required reimbursement of money lost to its revolving fund. However, we believe it would take a statutory change to reflect those savings in the regulations.

Changes: None.

Comment: One commenter felt that offering repayment incentives to borrowers who repay their loans in a timely fashion does nothing to help needy borrowers, the intended beneficiaries of the Federal Perkins Loan program, who may be struggling to repay their loans.

Discussion: While we appreciate the concerns expressed by the commenter regarding borrowers who may be struggling to repay their Federal Perkins Loan, the provision allowing institutions to offer incentive repayment discounts to borrowers who repay their loans timely is statutory and voluntary on the institution's part. Additionally, we believe that incentives encourage borrowers to repay in full, or to begin or maintain repayment on a regular basis, thereby replenishing an institution's revolving fund and making more money available to the needy individuals for whom Federal Perkins Loans are intended.

Changes: None.

Section 674.34 Deferment of repayment—Federal Perkins loans, National Direct Student loans and Defense loans

Comment: One commenter suggested that the final regulations be revised to extend the Federal Perkins Loan program deferments contained in statute prior to July 1, 1993 to borrowers who are currently eligible only for the deferments contained in section 464(c)(2)(A) of the HEA. The commenter believed that making this change would simplify the deferment process for borrowers and institutions and reduce the amount of paperwork that the deferment process requires.

Discussion: We are sympathetic to the commenter's suggestion. However, we are unable to revise the regulations to expand the deferments available to Federal Perkins Loan borrowers because it is beyond the scope of the 1998 Amendments change to the HEA and would require additional statutory change.

Changes: None.

Section 674.39 Loan Rehabilitation

Comment: We received many comments on the new loan rehabilitation provisions in this section. Many commenters questioned aspects of loan rehabilitation that are required by statute. Other commenters asked only for clarification regarding the rehabilitation process without objecting to or requesting revisions to the regulations.

Discussion: We cannot address requests for revisions to the proposed regulations that are inconsistent with the statute. We believe it is helpful to review the aspects of loan rehabilitation in the Perkins Loan Program that relate to borrower benefits and institutional responsibilities that are required by law, and therefore cannot be changed.

Under the 1998 Amendments, a defaulted loan is considered rehabilitated if ''the borrower of a loan made under this part who has defaulted on the loan'' makes the required 12 payments. Accordingly, loan rehabilitation is available to all defaulted borrowers with a loan made under the Federal Perkins Loan Program. If a borrower requests loan rehabilitation, the institution or its servicer must allow the borrower to rehabilitate his or her loan. This also applies to defaulted loans that an institution has placed with a collection agency. However, the borrower may only rehabilitate a defaulted loan once. Because the statute specifically refers to a stream of 12 payments as determined by the institution, the institution must work with the borrower to determine a payment amount that is appropriate. The statute does not require a signed rehabilitation agreement.

In accordance with the 1998 Amendments, once the loan is rehabilitated (after the 12th payment has been made), the institution or its servicer must request that any credit bureau to which the defaulted loan was reported remove the default from the borrower's credit history. The borrower is brought current and is no longer considered to be delinquent or in default. Removing the default is consistent with the requirements of the Fair Credit Reporting Act (FCRA), which requires that an institution correct and update the information it furnishes to a credit reporting agency. In this case, the institution would be updating the borrower's credit history to reflect the rehabilitation of the loan. The FCRA also requires credit reporting agencies to have reasonable procedures in place to accept updated or corrected information.

Once the loan is rehabilitated, the borrower is subject to the terms, conditions, benefits and privileges of the borrower's original promissory note. This includes eligibility for deferments, forbearance, cancellations, and flexible repayment options. The borrower is also subject to the same responsibilities under the note, which include, but are not limited to, making regular payments and informing the school or servicer of an address change or the need for flexible repayment arrangements. We sum up this status by saying the borrower is returned to regular repayment status in § 674.39(b)(1) of the regulations.

Finally, in accordance with the 1998 Amendments, a borrower who has rehabilitated his or her loan re-establishes eligibility for Title IV student financial assistance, as long as the borrower is otherwise eligible.

Changes: None.

Comment: One commenter requested clarification regarding when an institution must notify a defaulted borrower of the option and consequences of rehabilitating the loan. The commenter also asked us to specifically state what the consequences of loan rehabilitation are in the Federal Perkins Loan Program.

Discussion: An institution has several opportunities under the requirements in Subpart C-Due Diligence of the Federal Perkins Loan Program to notify a defaulted borrower of his or her option to rehabilitate. We will not regulate prescriptively in this area and will leave the timing of that notification to the institution. Clearly, however, once a borrower has begun to miss payments, the billing procedures in § 674.43 require an institution to contact the borrower to demand payment. A notification of the option and the consequences of loan rehabilitation can be included as part of any or all of these payment demands. We believe that this notification should be made no later than the final demand for payment required by § 674.43(d). Further, notification regarding the option and consequences of loan rehabilitation should also be provided during the more intensive efforts an institution, or its servicer, makes to recover amounts owed on a defaulted loan under § 674.45. Regardless of the timing of the notification and regardless of whether the institution is servicing the loan or a billing or collection agency is servicing the loan, the borrower may request rehabilitation of his or her defaulted loan at any time. Additionally, although the proposed regulations require that an institution notify only a defaulted borrower, institutions are encouraged to include information regarding loan rehabilitation as part of the disclosures regarding the definition and consequences of default required when making and disbursing a loan under § 674.16(a)(1)(x) and when conducting exit counseling under § 674.42(b)(2)(v).

The consequences of rehabilitating a defaulted loan of which the borrower should be advised include returning the borrower to regular repayment status, treating the first payment made under the twelve consecutive payments as the first payment in a new repayment period of up to 10 years, instructing any credit bureau to which the default was reported to remove the default from the borrower's credit history, and the re-establishment of the borrower's eligibility for Title IV student financial assistance, provided that the borrower is otherwise eligible.

Changes: None.

Comment: Several commenters requested clarification regarding whether or not a borrower must request loan rehabilitation. One commenter suggested that we revise the regulations to require that the borrower contact the institution prior to the first of the twelve payments so that the institution can work with the borrower to assure their successful rehabilitation.

Discussion: We agree that a borrower must notify the institution of his or her desire to rehabilitate a defaulted loan and believe this is implicitly stated in the regulations in describing rehabilitation as the making of 12 consecutive on-time, consecutive, monthly payments ''as determined by the institution.'' However, in order to avoid confusion and add clarity to this section, we have amended the regulations to require a request from the borrower. We note, however, that we are not specifying that the borrower's request be written nor that the borrower's request precede the 12 consecutive on-time, monthly payments.

Changes: We are adding the phrase ''and the borrower requests rehabilitation,'' to § 674.39(a)(2).

Comment: One commenter requested clarification regarding whether a revised repayment schedule is required for a rehabilitated loan.

Discussion: We will not specify in regulations that an institution must prepare a revised repayment agreement for a rehabilitated borrower. However, institutions are required under § 674.39(b)(2) to treat the first payment made under the 12 consecutive payments as the first payment under a new repayment period of up to 10 years. Servicing a rehabilitated loan in a manner consistent with program regulations would appear to necessitate a revised repayment agreement to ensure a borrower's successful repayment. We believe that a new revised repayment agreement is probably in the best interests of both the school and the borrower.

Changes: None.

Comment: One commenter requested clarification regarding when an institution may begin counting payments made by a borrower toward the rehabilitation of the borrower's defaulted loan. The commenter asked if only payments made on or after the effective date of the final regulations (July 1, 2000) may be counted toward the 12 payments the borrower is required to make in order to rehabilitate a defaulted loan or if payments made before the effective date of the final regulations may be counted toward the rehabilitation.

Discussion: An institution may count payments made before July 1, 2000, toward the 12 on-time, monthly payments the borrower must make to rehabilitate a defaulted Federal Perkins Loan as long as at least one of the 12 payments is made on or after the July 1, 2000, effective date of the final regulations.

Changes: None.

Comment: One commenter recommended that we revise the regulations to prohibit a borrower from rehabilitating a defaulted Federal Perkins Loan on which a judgment has been rendered because the judgment has taken the place of the original promissory note as the debt instrument.

Discussion: We disagree that the regulations should be revised to prohibit borrowers from rehabilitating a defaulted loan on which a judgment has been rendered. We interpret section 464(h) of the HEA to require that a rehabilitation program must be available to all defaulted borrowers even if the institution has secured a judgment against the borrower. This is consistent with the statutory interpretation of loan rehabilitation in both the FFEL and Federal Direct Loan Programs. However, we share the commenter's concern that the promissory note already signed by the borrower in these cases no longer embodies that borrower's obligations with respect to the debt. Therefore, the borrower of a defaulted loan on which a judgment has been entered must sign a new promissory note that incorporates outstanding principal after making the 12 on-time, consecutive, monthly payments required by rehabilitation. In addition to the amount of the new promissory note, the borrower is responsible for interest and late charges that accrued while the borrower was in default. The borrower is also subject to the same 24 percent limit on collection costs once the loan has been rehabilitated.

Changes: We have amended § 674.39 by adding a new paragraph (a)(3) to require a defaulted borrower to sign a new promissory note if the institution has a judgment against the borrower.

Comment: Several commenters objected to extending a new ten-year repayment period to rehabilitated borrowers because it would delay the replenishment of the institution's revolving fund and is inequitable to other Federal Perkins Loan borrowers. One commenter recommended that a borrower be required to repay the outstanding balance on a rehabilitated loan in the remaining time left in the borrower's original ten-year repayment period. Further, this commenter felt that if the borrower's original ten-year repayment period had elapsed, the borrower should be required to repay the defaulted loan in full in the twelve payments that constitute rehabilitation.

Discussion: The point of rehabilitation is to return the borrower to regular repayment on a defaulted loan to ensure successful payment in full. We do not believe that rehabilitating a borrower's loan only to encourage redefault by establishing an unreasonable repayment schedule is within the intent of the rehabilitation program. Further, a successful post-rehabilitation payment returns money to an institution's revolving fund and reduces costs associated with default collections. The extension of a new repayment period of up to 10 years, which assumes minimum monthly payments in some cases, is also consistent with the rehabilitation provisions in the Federal Family Education Loan and the Federal Direct Loan Programs.

Changes: None.

Comment: One commenter asked whether an institution may shorten a rehabilitated borrower's repayment period by requiring a minimum monthly payment.

Discussion: An institution may require a borrower to pay a minimum monthly payment on a rehabilitated loan only if the institution required a minimum monthly payment under the borrower's original promissory note and the payment amount due on the rehabilitated loan is less than the minimum monthly payment. This does not preclude the borrower and the institution from agreeing to a monthly repayment amount on a rehabilitated loan that repays the loan in less than 10 years if the institution did not exercise the minimum monthly payment option in the original note. As stated earlier, a new repayment period of up to 10 years, assuming a minimum monthly payment in some cases, is extended to a rehabilitated borrower to ensure that the borrower successfully rehabilitates the loan.

Changes: None.

Comment: One commenter supported the provision returning the benefits and privileges of the original promissory note to the rehabilitated borrower, but believed that the regulations should reflect the borrower's eligibility only for the remaining balance of those privileges under the statutory maximums contained in the HEA. For example, if a borrower had received one year of forbearance before rehabilitating the loan, the borrower would be eligible for only two years of forbearance after rehabilitation.

Discussion: We agree that the borrower is eligible only for the statutory maximums on benefits available under the original promissory note and that language reflecting this change would improve the clarity of the regulations.

Changes: Section 674.39(d) has been changed to specify that the borrower regains eligibility for the balance of benefits and privileges available under the original promissory note.

Comment: Several commenters requested clarification regarding whether an institution must require the return of a rehabilitated loan from a collection agency after receipt of the required 12 consecutive monthly payment amounts.

One commenter, noting the borrower's return to regular repayment status, the return of all of the benefits and privileges of the original promissory note, and the borrower's ability to request flexible repayment options, stated that collection agencies typically focus only on collecting the total amount of any debt placed with it and not on servicing loans in regular repayment status. The commenter stated that the return of these benefits would suggest the return of the account to the institution.

Discussion: The issue of whether a loan may remain with a collection agency after rehabilitation was discussed during negotiated rulemaking. Committee II reached consensus on the rehabilitation provisions in this section with the understanding that an institution may allow a rehabilitated loan to remain with a collection agency.

The institution is responsible for insuring that any third party servicer with which it contracts is in compliance with required statutory and regulatory program requirements, which would include the requirements of rehabilitation in the Federal Perkins Loan program. If the institution chooses to leave the rehabilitated account with a collection agency, the collection agency must provide the rehabilitated borrower with all of the benefits associated with loan rehabilitation and required by this section. An institution may leave a rehabilitated loan with a collection agency only if that agency is capable of providing the following services in a manner consistent with program regulations:

- billing the borrower (§ 674.43);

- processing deferment and cancellation requests (§§ 674.34, 674.35, 674.36, 674.37, 674.38 and Subpart D-Loan Cancellation);
- providing flexible repayment arrangements in accordance with the terms of the promissory note (§ 674.33);
- providing any notice or disclosure required under the program regulations (Subpart C-Due Diligence); and
- providing any other statutory or regulatory benefit to which the borrower is entitled.

If the collection agency is unable to provide a rehabilitated borrower with the benefits of rehabilitation, the institution must remove the account from the agency.

Changes: None.

Comment: Many commenters objected to the provision limiting collection costs that can be charged to the borrower on a rehabilitated loan to 24 percent of the unpaid principal and accrued interest.

Several commenters believed that it will be problematic to renegotiate contracts with collection agencies and that the terms of collection agency contracts should be flexible and subject only to negotiation between the school and the collection agency. They believed that the 24 percent cap on collection costs that can be passed on to a rehabilitated borrower will limit the number of collection agencies an institution is able to contract with to those collection agencies that charge lower rates as opposed to those that are best at recovering debts, thereby limiting the ability of an institution to maximize the return of funds to its revolving fund.

Several commenters stated that accounting for collection costs that are different depending on the type of loan on which they are assessed is burdensome, confusing and time-consuming. The commenters questioned why rehabilitated loans should be treated differently than other Federal Perkins Loans since, under the terms of their promissory notes, all borrowers are responsible for reasonable collection costs incurred by an institution in collecting the loan.

Discussion: We disagree that the renegotiation of collection agency contracts will be problematic and that schools will be limited in their choice of collection agencies to those that charge lower fees as opposed of those that are best at collecting debts. We believe that the marketplace will generate competition among collection agencies and that collection agencies will adapt their rates and their servicing practices to those rates and practices required to service rehabilitated loans. We also believe that a borrower is more likely to continue paying on his or her loan once the loan is rehabilitated and that these payments will replenish an institution's revolving fund, not deplete it.

We further believe that collection costs on a rehabilitated loan should be reduced once the borrower has successfully rehabilitated a defaulted loan. A rehabilitated borrower has re-established eligibility for Title IV student financial assistance, is once again entitled to all of the benefits and privileges available under the promissory note and, most importantly, is no longer considered to be in default on the loan. We believe that to assess collection costs on a loan in good standing at a rate higher than the 24 percent maximum is excessive.

Lastly, a reduction in the collection costs that can be charged to a rehabilitated borrower was intensely debated during the negotiated rulemaking process. Committee II reached consensus on a collection cost cap of 24 percent. This rate is consistent with the reduction of collection costs that may be charged to a rehabilitated borrower in the FFEL and Federal Direct Loan Programs, adjusted to allow for the fact that collection costs cannot be capitalized in the Federal Perkins Loan program as they are in the FFEL and Direct Loan programs.

Changes: None.

Comment: Two commenters, while not objecting to the proposed regulations agreed to by the negotiators that cap the collection costs that can be charged to a rehabilitated borrower at 24 percent, expressed concern that the preamble language in the NPRM does not accurately reflect current Federal policy contained in 34 CFR 30.60 on assessing collection costs to defaulted borrowers. The commenters stated that institutions and their servicers would be forced to incur significant expenses in reprogramming and redesigning current systems and procedures to comply with a process that required them to calculate a 24 percent cap on collection costs on the unpaid principal and accrued interest remaining on the loan at the time it is rehabilitated.

The commenters also expressed concern that the NPRM preamble language states that payments on a rehabilitated loan cannot be treated on a "fee-on-fee," basis which is a widely accepted method for determining collection costs on delinquent debtors. The commenters expressed confidence, however, that institutions and servicers could utilize current systems and procedures, along with the fee-on-fee method of determining collection costs, in such a way as to not exceed the 24 percent cap on rehabilitated loans.

Conversely, three commenters suggested that the text of the preamble discussion be included in the final regulations. They believed that this would provide clarity to the regulations and guard against the possibility that a rehabilitated borrower would be charged in excess of the 24 percent cap on collection costs after the loan has been successfully rehabilitated.

Discussion: The preamble language contained in the NPRM accurately describes the basis on which consensus was reached on the 24 percent cap on collection costs that may be charged on a rehabilitated Federal Perkins Loan. Default-related collection costs of up to 18.5 percent are passed along to the borrower of a rehabilitated FFEL or Federal Direct Loan, are capitalized, and become part of the rehabilitated principal on which interest accrues after rehabilitation. As a result, an FFEL or Federal Direct Loan borrower ultimately pays post-rehabilitation collection costs of approximately 24 percent over the remaining life of the loan. In order to treat rehabilitated borrowers consistently across the Title IV loan programs, the negotiators agreed to a generally comparable 24 percent cap on collection costs on a rehabilitated Federal Perkins Loan, acknowledging that because collection costs in the Federal Perkins Loan Program cannot be capitalized they must be treated as a separate cost. The use of current Federal policy contained in 34 CFR 30.60 when assessing collection costs on a rehabilitated Federal Perkins loan was not specifically discussed. However, several negotiators were very concerned that the 24 percent cap on collection costs on a rehabilitated Federal Perkins loan would be exceeded depending on how the payments from the borrower were applied.

An institution, or its servicer, charges a commission on each payment the borrower makes on a defaulted loan using the formula in 34 CFR 30.60(a)(1). The formula does not take into account interest that continues to accrue on the outstanding balance of a defaulted loan as it is paid down. However, because a rehabilitated loan is no longer considered to be in default, interest must be a factor when applying payments to a rehabilitated loan. Therefore, if an institution or its servicer uses the formula contained in 34 CFR 30.60, it must ensure that when the commissions retained on payments received from the borrower on a rehabilitated loan reach an amount equal to 24 percent of the original principal and accrued interest that remained on the loan after the borrower made the 12 payments, no more costs may be calculated or assessed against the borrower.

We agree that clarifying the regulations to guard against the possibility that a rehabilitated borrower will be charged collection costs in excess of the 24 percent cap is appropriate. An institution, or its servicer, must consider the interest that accrues on the outstanding balance of the rehabilitated loan over the length of the post-rehabilitation repayment period to ensure that collection costs of no more than 24 percent of the unpaid principal and accrued interest as of the date following application of the twelfth payment are paid by the borrower.

Changes: Section 674.39(c)(1) has been changed to specify that collection costs, if charged to the borrower, may not exceed 24 percent of the unpaid principal and accrued interest as of the date following application of the twelfth payment.

Comment: One commenter believed that the regulations should be revised to allow an institution to charge collection costs not paid by the borrower on a rehabilitated loan to its revolving fund if the borrower subsequently redefaults.

Discussion: We disagree that the regulations should be revised to allow an institution to charge its revolving fund for collection costs not paid by the borrower if the borrower subsequently redefaults. If the borrower redefaults on a rehabilitated loan, the borrower would be responsible for paying any reasonable collection costs incurred by the institution in attempting to collect the debt. We would note that if a rehabilitated loan is being serviced by a collection agency, § 674.48(e) of the Federal Perkins Loan Program regulations requires an institution to recall the loan and place it with a different collection agency if the loan redefaults. Section 674.48(b) prohibits an institution from using a billing service (which are the duties assumed by the collection agency upon the successful rehabilitation of a loan) and a collection agency that is owned or controlled by the same entity.

Changes: None.

Section 674.41 Due Diligence—General requirements

Comment: Several commenters objected to the requirement that, as part of an institution's general due diligence activities, it provide the borrower with information on the availability of the Student Loan Ombudsman's office if the borrower disputes the terms of the loan in writing and the institution does not resolve the dispute. The commenters felt there was no need for a Student Loan Ombudsman's office, that it would be an unnecessary expense and that it would be a bureaucratic intrusion between the institution and the borrower. We received similar objections to the addition of language in §§ 674.42 and 674.45 that requires an institution to inform borrower's of the availability of the Student Loan Ombudsman's office.

Discussion: The 1998 Amendments require the Department of Education to appoint a Student Loan Ombudsman who must receive, review and attempt to resolve informally complaints from borrowers regarding the terms of their loans. Although there is no specific statutory requirement that institutions or other loan participants disseminate information regarding the availability of the Student Loan Ombudsman to borrowers, the negotiators for Committees I and II agreed that as our partners in student loan administration, it made sense for loan participants, as well as the Department, to provide borrowers with information on the Student Loan Ombudsman's office. The negotiators agreed that adding a provision on the availability of this service to § 674.41, as well as to §§ 674.42 and 674.45, will increase borrower awareness and greatly enhance successful repayment of student loans and reduce defaults.

Changes: None

Comment: Several commenters expressed concern that the proposed regulations did not address what kind of information an institution must provide to borrowers when complying with the requirement to inform them about the availability of the Student Loan Ombudsman's office. One commenter felt that the proposed regulations should be revised to require institutions to provide the borrower with information on the availability of the Student Loan Ombudsman's office only as that information is provided to institutions by the Secretary.

Discussion: The proposed regulations require that an institution provide the borrower with information about the availability of the Student Loan Ombudsman's office. This information is meant to convey to the borrower that, if the borrower is unable to resolve a dispute with the loan holder, another avenue of redress is available. An institution may comply with this requirement by providing the borrower with the Ombudsman's website address or mailing address at the Department of Education. The Student Loan Ombudsman's website address is http://www.sfahelp.ed.gov.

Changes: None.

Section 674.42 Contact with the borrower

Comment: One commenter applauded our initiative to allow for loan counseling through interactive electronic means but objected to the requirement that the institution obtain through return receipt or some other mechanism documentation that the student received and completed the materials when electronic exit counseling is used. The commenter believed that obtaining return receipt that the student received and completed electronic exit counseling was too high a standard of compliance for institutions to meet and suggested that we adopt the receipt standards of the U.S. Postal Service, which are that if mail is not returned to the sender, it can be considered delivered.

Discussion: We disagree that obtaining documentation that the borrower has received and completed exit counseling, either through return receipt or some other mechanism, is too high a standard to require when an institution provides exit counseling electronically. Institutions were previously required to provide exit counseling to their borrowers either in person or in a group to ensure that borrowers received and completed exit counseling. We believe that providing exit counseling electronically should be viewed as comparable to providing in person counseling and should provide the same assurances.

The standards of the U.S. Postal service provide that if mail is not returned to the sender, it can be considered delivered. Because there is currently no similar standard for electronic mail, we believe that it is in the best interest of borrowers to require an institution to take reasonable steps to ensure that each student borrower receives the counseling materials and participates in and completes interactive electronic exit counseling given the current available technology.

Changes: None.

Comment: One commenter supported the requirement that an institution provide a borrower with an explanation of any options the borrower might have to consolidate or refinance his or her loan during exit counseling. However, the commenter suggested that we require institutions to inform Federal Perkins Loan borrowers that the interest rate on a consolidation loan may be higher than the 5 percent interest rate on their Federal Perkins loan.

Discussion: Because Federal Perkins loan borrowers lose eligibility for cancellation benefits and are charged a different rate of interest upon consolidating their Perkins loans, we agree that disclosing the consequences of consolidating a Federal Perkins loan will help borrowers make an informed decision.

Change: Section 674.42(b)(2)(ii) has been amended to require an institution to inform borrowers about the consequences of consolidating a Federal Perkins Loan.

Comment: One commenter stated that the provision requiring schools to provide borrowers with ''additional matters that the Secretary recommends that a school include in the exit counseling or materials set forth in Appendix D to 34 CFR 668'' be deleted. The commenter believes that such a requirement is unnecessary especially given the elimination of default reduction plans in the Federal Perkins Loan Program.

Discussion: We disagree that this provision should be deleted. Including additional information recommended by the Secretary or materials in Appendix D in exit counseling is an option, not a requirement. We believe that Appendix D is a useful resource to institutions when counseling borrowers on default avoidance.

Changes: None.

Section 674.47 Costs chargeable to the fund

Comment: One commenter expressed concern that institutions may be unable to renegotiate collection agency contracts by July 1, 2002 that comply with the requirement that no more than 24 percent of the unpaid principal and accrued interest remaining on the loan at the time the loan is rehabilitated can be assessed a borrower in collection costs. The commenter requested that we include an explicit commitment in the preamble of the final regulations to revisit this issue if the majority of institutions are unable to renegotiate contracts to account for the 24 percent collection costs cap.

Discussion: We believe that because this will be a general program requirement, the market will expand to meet institutional needs. Further, we believe it is inappropriate for us to commit to a regulatory change outside of the negotiated rulemaking process required by the 1998 Amendments. However, we will carefully consider this provision in the future as part of our ongoing regulatory review.

Changes: None.

Section 674.49 Bankruptcy of borrower

Comment: One commenter submitted a detailed analysis of § 674.49 and suggested substantive changes to this section of the regulations. These suggested changes included eliminating paragraph (b), which requires an institution to file a proof of claim in a bankruptcy; eliminating paragraph (e), which outlines an institution's responsibilities when a borrower files a Chapter 13 bankruptcy; and, clarifying paragraph (g)(1)(i), which deals with termination of collection and write-off of the loan under certain circumstances.

Discussion: We appreciate the analysis of § 674.49 submitted by the commenter. However, we did not propose to amend this section other than to:

- Reflect the change to the bankruptcy code that eliminates a borrower's ability to discharge a loan in bankruptcy on the basis of the loan being in repayment for more than seven years, and require all borrowers who seek discharge of a Perkins loan to prove undue hardship;
- Clarify that the seven year repayment period on bankruptcies filed before October 8, 1998, excludes applicable suspensions of the repayment period; and
- Insert language stating that the institution must use diligence and may assert any defense consistent with its status under applicable law to avoid the discharge of the loan.

While this section may undoubtedly deserve closer scrutiny, we do not believe it is appropriate to make the changes suggested by the commenter outside of the negotiating rulemaking process.

Changes: None.

Comment: One commenter suggested that we delete § 674.49(4)(i), which requires an institution to monitor the borrower's compliance with the requirements of a Chapter 13 repayment plan, and to take certain steps if the borrower has not made payments or has requested a hardship discharge on the debt. The commenter asserted that the institution has no legal grounds to monitor the borrower unless the institution appoints a trustee.

Discussion: The code expressly directs that a trustee be appointed for every Chapter 13 proceeding and authorizes any ''party in interest'' or ''creditors'' to move for any of a number of reasons to have a Chapter 13 proceeding dismissed or converted to a Chapter 7, 11 U.S.C. 1302, 1307(c). Because the comment has no basis in the law, we disagree with the commenter's suggestion that we delete this paragraph from the regulations. The proposed changes to this paragraph reflect only the deletion of language that referred to loans held by an institution that had been in repayment for more than seven years. We believe that any further changes in this section of the regulation should be undertaken only as part of negotiated rulemaking process.

Changes: None.

Comment: One commenter noted an inconsistency between the preamble discussion on § 674.49(c)(1) and the proposed regulatory language. Specifically, the preamble states that ''the proposed regulations would amend this section to 'require' institutions to use due diligence and assert any defense consistent with its status.'' The actual regulatory language states that ''the institution must use diligence and 'may' assert any defense consistent with its status.'' The commenter requested that we correct the preamble in the NPRM.

Discussion: Any inconsistency between the preamble and the proposed regulatory language was not intended. Recently, some State institutions have responded to undue hardship complaints by asserting that sovereign immunity barred relief on these claims in bankruptcy proceedings. We intend the proposed amendment to make clear that every institution must use due diligence to oppose discharge, but that State institutions may do so—if they wish—by asserting sovereign immunity as a defense to an undue hardship complaint. Unfortunately, some courts misconstrue Department regulations to bar State institutions from asserting sovereign immunity in these circumstances. We intend this amendment as an authoritative explanation of the meaning of the Federal Perkins Loan regulations and Program Participation Agreement on this due diligence obligation.

Changes: None.

Section 674.54 Teacher cancellation—Federal Perkins loans and Direct loans made before July 23, 1992

Comment: One commenter suggested that we consider removing and reserving § 674.54 of the Federal Perkins Loan Program regulations because it is redundant with § 674.53. (Section 674.54 authorizes teaching cancellation benefits for Federal Perkins Loans and Direct Loans made before July 23, 1992. All borrowers with loans made before July 23, 1992 are eligible for all of the cancellation provisions contained in § 674.53.)

Discussion: We agree that § 674.54 is redundant and should be removed and reserved. We note that borrowers who teach handicapped students and receive cancellation benefits under § 674.54(b) remain eligible for cancellation under § 674.53(b)—Full time teaching in special education.

Changes: Section 674.54 is removed and reserved.

Executive Order 12866

We have reviewed these final regulations in accordance with Executive Order 12866. Under the terms of the order we have 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 we have determined to be necessary for administering this program effectively and efficiently.

In assessing the potential costs and benefits—both quantitative and qualitative—of these final regulations, we have determined that the benefits of the regulations justify the costs.

We have also determined that this regulatory action does not unduly interfere with State, local, and tribal governments in the exercise of their governmental functions.

Paperwork Reduction Act of 1995

The Paperwork Reduction Act of the 1995 does not require you to respond to a collection of information unless it displays a valid OMB control number. We display the valid OMB control numbers assigned to the collections of information in these final regulations at the end of the affected sections of the regulations.

Intergovernmental Review

This program is subject to the requirements of Executive Order 12372 and the regulations in 34 CFR part 79. The objective of the Executive Order is to foster an intergovernmental partnership and a strengthened federalism by relying on processes developed by State and local governments for coordination and review of proposed Federal financial assistance.

In accordance with the order, we intend this document to provide early notification of the Department's specific plans and actions for this program.

Assessment of Educational Impact

In the NPRM we requested comments on whether the proposed regulations would require transmission of information that any other agency or authority of the United States gathers or makes available.

Based on the response to the NPRM and on our review, we have determined that these final regulations do not require transmission of information that any other agency or authority of the United States gathers or makes available.

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(Catalog of Federal Domestic Assistance Number: 84.037 Federal Perkins Loan Program)

List of Subjects in 34 CFR Part 674

Loan programs—education, Student aid, Reporting and recordkeeping requirements.

Dated: October 20, 1999.

Richard W. Riley,

Secretary of Education.

PART 674—FEDERAL PERKINS LOAN PROGRAM

1. The authority citation for part 674 continues to read as follows:

Authority: 20 U.S.C. 1087aa–1087ii and 20 U.S.C. 421–429, unless otherwise noted.

2. Section 674.2(b) is amended by adding, in alphabetical order, a definition of ''satisfactory repayment arrangement,'' to read as follows:

§ 674.2 Definitions.

* * * * *

(b) * * *

Satisfactory repayment arrangement: For purposes of regaining eligibility for grant, loan, or work assistance under Title IV of the HEA, to the extent that the borrower is otherwise eligible, the making of six (6) on-time, consecutive, monthly payments on a defaulted loan. A borrower may obtain the benefit of this paragraph with respect to renewed eligibility once on a defaulted loan.

* * * * *

3. Section 674.5 is amended as follows:

A. By revising paragraphs (a)(1) and (a)(2).

B. By removing paragraphs (a)(3) and (a)(4).

C. By removing paragraph (b)(2) and redesignating paragraph (b)(3) as paragraph (b)(2).

D. By removing paragraph (c)(4); and redesignating paragraph (c)(3)(ii) as paragraph (c)(4) and by removing '';and'' at the end of the sentence in the new paragraph (c)(4) and adding, in its place, a period; and by revising paragraph (c)(3).

E. By removing paragraphs (e) and (f).

§ 674.5 Federal Perkins Loan Program cohort default rate and penalties.

(a) * * *

(1) *FCC reduction.* If the institution's cohort default rate equals or exceeds 25 percent, the institution's FCC is reduced to zero.

(2) *Ineligibility.* For award year 2000–2001 and succeeding award years, an institution with a cohort default rate that equals or exceeds 50 percent for each of the three most recent years for which cohort default rate data are available is ineligible to participate in the Federal Perkins Loan Program. Following a review of that data and upon notification by the Secretary, an institution is ineligible to participate for the award year, or the remainder of the award year, in which the determination is made and the two succeeding award years. An institution may appeal a notification of ineligibility from the Secretary within 30 days of its receipt.

(i) *Appeal procedures.*

(A) *Inaccurate calculation.* An institution may appeal a notice of ineligibility based upon the submission of erroneous data by the institution, the correction of which would result in a recalculation that reduces the institution's cohort default rate to below 50 percent for any of the three award years used to make a determination of ineligibility. The Secretary considers the edit process, by which an institution adjusts the cohort default rate data that it submits to the Secretary on its Fiscal Operations Report, to constitute the procedure to appeal a determination of ineligibility based on a claim of erroneous data.

(B) *Small number of borrowers entering repayment.* An institution may appeal a notice of ineligibility if, on average, 10 or fewer borrowers enter repayment for the three most recent award years used by the Secretary to make a determination of ineligibility.

(C) *Decision of the Secretary.* The Secretary issues a decision on an appeal within 45 days of the institution's submission of a complete, accurate, and timely appeal. An institution may continue to participate in the program until the Secretary issues a decision on the institution's appeal.

(ii) *Liquidation of an institution's Perkins Loan portfolio.* Within 90 days of receiving a notification of ineligibility or, if the institution appeals, within 90 days of the Secretary's decision to deny the appeal, the institution must—

(A) Liquidate its revolving student loan fund by making a capital distribution of the liquid assets of the Fund according to section 466(c) of the HEA; and

(B) Assign any outstanding loans in the institution's portfolio to the Secretary in accordance with § 674.50.

(iii) *Effective date.* The provisions of paragraph (a)(2) of this section are effective with the cohort default rate calculated as of June 30, 2001.

* * * * *

(c) * * *

(3)(i) In determining the number of borrowers who default before the end of the following award year, a loan is excluded if the borrower has—

(A) Voluntarily made six consecutive monthly payments;

(B) Voluntarily made all payments currently due;

(C) Repaid the full amount due, including any interest, late fees, and collection costs that have accrued on the loan;

(D) Received a deferment or forbearance based on a condition that predates the borrower reaching a 240- or 270-day past due status; or

(E) Rehabilitated the loan after becoming 240- or 270-days past due.

(ii) A loan is considered canceled and also excluded from an institution's cohort default rate calculation if the loan is—

(A) Discharged due to death or permanent and total disability;

(B) Discharged in bankruptcy;

(C) Discharged due to a closed school; or

(D) Repaid in full in accordance with § 674.33(e) or § 674(h).

(iii) For the purpose of this section, funds obtained by income tax offset, garnishment, income or asset execution, or pursuant to a judgment are not considered voluntary.

* * * * *

§ 674.9 [Removed and Reserved]

4. Section 674.6 is removed and reserved.

§ 674.7 [Removed and Reserved]

5. Section 674.7 is removed and reserved.

6. Section 674.9 is amended by redesignating paragraph (i) as paragraph (j) and adding a new paragraph (i) to read as follows:

§ 674.9 Student eligibility.

* * * * *

(i) In the case of a borrower who is in default on a Federal Perkins Loan, NDSL or Defense loan, satisfies one of the conditions contained in § 674.5(c)(3)(i) or (ii) except that—

(1) For the purposes of this section, voluntary payments made by the borrower under paragraph (i) of this section are those payments made directly by the borrower, including payments made over and above payments made pursuant to a judgment; and

(2) Voluntary payments do not include payments obtained by income tax refund offset, garnishment, income or asset execution, or pursuant to a judgment.

* * * * *

7. Section 674.12 is amended by revising paragraphs (a), (b), and (d) to read as follows:

§ 674.12 Loan maximums.

(a) The maximum annual amount of Federal Perkins Loans and Direct Loans an eligible student may borrow is—

(1) $4,000 for a student who is enrolled in a program of undergraduate education; and

(2) $6,000 for a graduate or professional student.

(b) The aggregate unpaid principal amount of all Federal Perkins Loans and Direct Loans received by an eligible student may not exceed—

(1) $20,000 for a student who has successfully completed two years of a program leading to a bachelor's degree but who has not received the degree;

(2) $40,000 for a graduate or professional student; and

(3) $8,000 for any other student.

* * * * *

(d) For each student, the maximum annual amounts described in paragraphs (a) and (c) of this section, and the aggregate maximum amounts described in paragraphs (b) and (c) of this section, include any amounts borrowed previously by the student under title IV, part E of the HEA at any institution.

* * * * *

8. Section 674.16 is amended by revising paragraph (i) and the Office of Management and Budget control number to read as follows:

§ 674.16 Making and disbursing loans.

* * * * *

(i)(1) An institution must report to at least one national credit bureau—

(i) The amount and the date of each disbursement;

(ii) Information concerning the repayment and collection of the loan until the loan is paid in full; and

(iii) The date the loan was repaid, canceled, or discharged for any reason.

(2) An institution must promptly report any changes to information previously reported on a loan to the same credit bureaus to which the information was previously reported.

(Approved by the Office of Management and Budget under control number 1845–0019)

* * * * *

9. Section 674.31 is amended by redesignating paragraphs (b)(2)(i) (C) and (D) as (D) and (E), respectively; by adding new paragraph (b)(2)(i)(C); by revising paragraph (b)(10)(i); and by revising the Office of Management and Budget control number to read as follows:

§ 674.31 Promissory note.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(C) For purposes of establishing the beginning of the repayment period for Direct or Perkins loans, the 6- and 9-month grace periods referenced in paragraph (b)(2)(i) of this section exclude any period during which a borrower who is a member of a reserve component of the Armed Forces named in section 10101 of Title 10, United States Code is called or ordered to active duty for a period of more than 30 days. Any single excluded period may not exceed three years and includes the time necessary for the borrower to resume enrollment at the next available regular enrollment period. Any Direct or Perkins loan borrower who is in a grace period when called or ordered to active duty as specified in this paragraph is entitled to a new 6- or 9-month grace period upon completion of the excluded period.

* * * * *

(10) * * *

(i) The institution must disclose to at least one national credit bureau the amount of the loan made to the borrower, along with other relevant information.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0019)

10. Section 674.33 is amended by adding new paragraphs (f) and (g); and by revising the Office of Management and Budget Control number to read as follows:

§ 674.33 Repayment.

* * * * *

(f)(1) *Incentive repayment program.* An institution may establish the following repayment incentives:

(i) A reduction of no more than one percent of the interest rate on a loan on which the borrower has made 48 consecutive, monthly repayments.

(ii) A discount of no more than five percent on the balance owed on a loan which the borrower pays in full prior to the end of the repayment period.

(iii) With the Secretary's approval, any other incentive the institution determines will reduce defaults and replenish its Fund.

(2) *Limitation on the use of funds.* (i) The institution must reimburse its Fund, on at least a quarterly basis, for money lost to its Fund that otherwise would have been paid by the borrower as a result of establishing a repayment incentive under paragraphs (f)(1)(i), (ii) and (iii) of this section.

(ii) An institution may not use Federal funds, including Federal funds from the student loan fund, or institutional funds from the student loan fund to pay for any repayment incentive authorized by this section.

(g) *Closed school discharge.* (1) *General.* (i) The holder of an NDSL or a Federal Perkins Loan discharges the borrower's (and any endorser's) obligation to repay the loan if the borrower did not complete the program of study for which the loan was made because the school at which the borrower was enrolled closed.

(ii) For the purposes of this section—

(A) A school's closure date is the date that the school ceases to provide educational instruction in all programs, as determined by the Secretary;

(B) "School" means a school's main campus or any location or branch of the main campus; and

(C) The "holder" means the Secretary or the school that holds the loan.

(2) *Relief pursuant to discharge.* (i) Discharge under this section relieves the borrower of any past or present obligation to repay the loan and any accrued interest or collection costs with respect to the loan.

(ii) The discharge of a loan under this section qualifies the borrower for reimbursement of amounts paid voluntarily or through enforced collection on the loan.

(iii) A borrower who has defaulted on a loan discharged under this section is not considered to have been in default on the loan after discharge, and such a borrower is eligible to receive assistance under programs authorized by title IV of the HEA.

(iv) The Secretary or the school, if the school holds the loan, reports the discharge of a loan under this section to all credit bureaus to which the status of the loan was previously reported.

(3) *Determination of borrower qualification for discharge by the Secretary.* The Secretary may discharge the borrower's obligation to repay an NDSL or Federal Perkins Loan without an application if the Secretary determines that—

(i) The borrower qualified for and received a discharge on a loan pursuant to 34 CFR 682.402(d) (Federal Family Education Loan Program) or 34 CFR 685.213 (Federal Direct Loan Program), and was unable to receive a discharge on an NDSL or Federal Perkins Loan because the Secretary lacked the statutory authority to discharge the loan; or

(ii) Based on information in the Secretary's possession, the borrower qualifies for a discharge.

(4) *Borrower qualification for discharge.* Except as provided in paragraph (g)(3) of this section, in order to qualify for discharge of an NDSL or Federal Perkins Loan, a borrower must submit to the holder of the loan a written request and sworn statement, and the factual assertions in the statement must be true. The statement need not be notarized but must be made by the borrower under penalty of perjury. In the statement the borrower must—

(i) State that the borrower—

(A) Received the proceeds of a loan to attend a school;

(B) Did not complete the program of study at that school because the school closed while the student was enrolled, or the student withdrew from the school not more than 90 days before the school closed (or longer in exceptional circumstances); and

(C) Did not complete and is not in the process of completing the program of study through a teachout at another school as defined in 34 CFR 602.2 and administered in accordance with 34 CFR 602.207(b)(6), by transferring academic credit earned at the closed school to another school, or by any other comparable means;

(ii) State whether the borrower has made a claim with respect to the school's closing with any third party, such as the holder of a performance bond or a tuition recovery program, and, if so, the amount of any payment received by the borrower or credited to the borrower's loan obligation; and

(iii) State that the borrower—

(A) Agrees to provide to the holder of the loan upon request other documentation reasonably available to the borrower that demonstrates that the borrower meets the qualifications for discharge under this section; and

(B) Agrees to cooperate with the Secretary in enforcement actions in accordance with paragraph (g)(6) of this section and to transfer any right to recovery against a third party to the Secretary in accordance with paragraph (g)(7) of this section.

(5) *Fraudulently obtained loans.* A borrower who secured a loan through fraudulent means, as determined by the ruling of a court or an administrative tribunal of competent jurisdiction, is ineligible for a discharge under this section.

(6) *Cooperation by borrower in enforcement actions.*

(i) In order to obtain a discharge under this section, a borrower must cooperate with the Secretary in any judicial or administrative proceeding brought by the Secretary to recover amounts discharged or to take other enforcement action with respect to the conduct on which the discharge was based. At the request of the Secretary and upon the Secretary's tendering to the borrower the fees and costs that are customarily provided in litigation to reimburse witnesses, the borrower must—

(A) Provide testimony regarding any representation made by the borrower to support a request for discharge;

(B) Provide any documents reasonably available to the borrower with respect to those representations; and

(C) If required by the Secretary, provide a sworn statement regarding those documents and representations.

(ii) The holder denies the request for a discharge or revokes the discharge of a borrower who—

(A) Fails to provide the testimony, documents, or a sworn statement required under paragraph (g)(6)(i) of this section; or

(B) Provides testimony, documents, or a sworn statement that does not support the material representations made by the borrower to obtain the discharge.

(7) *Transfer to the Secretary of borrower's right of recovery against third parties.* (i) In the case of a loan held by the Secretary, upon discharge under this section, the borrower is deemed to have assigned to and relinquished in favor of the Secretary any right to a loan refund (up to the amount discharged) that the borrower may have by contract or applicable law with respect to the loan or the enrollment agreement for the program for which the loan was received, against the school, its principals, its affiliates and their successors, its sureties, and any private fund, including the portion of a public fund that represents funds received from a private party.

(ii) The provisions of this section apply notwithstanding any provision of State law that would otherwise restrict transfer of those rights by the borrower, limit or prevent a transferee from exercising those rights, or establish procedures or a scheme of distribution that would prejudice the Secretary's ability to recover on those rights.

(iii) Nothing in this section limits or forecloses the borrower's right to pursue legal and equitable relief regarding disputes arising from matters unrelated to the discharged NDSL or Federal Perkins Loan.

(8) *Discharge procedures.* (i) After confirming the date of a school's closure, the holder of the loan identifies any NDSL or Federal Perkins Loan borrower who appears to have been enrolled at the school on the school closure date or to have withdrawn not more than 90 days prior to the closure date.

(ii) If the borrower's current address is known, the holder of the loan mails the borrower a discharge application and an explanation of the qualifications and procedures for obtaining a discharge. The holder of the loan also promptly suspends any efforts to collect from the borrower on any affected loan. The holder of the loan may continue to receive borrower payments.

(iii) In the case of a loan held by the Secretary, if the borrower's current address is unknown, the Secretary attempts to locate the borrower and determine the borrower's potential eligibility for a discharge under this section by consulting with representatives of the closed school or representatives of the closed school's third-party billing and collection servicers, the school's licensing agency, the school accrediting agency, and other appropriate parties. If the Secretary learns the new address of a borrower, the Secretary mails to the borrower a discharge application and explanation and suspends collection, as described in paragraph (g)(8)(ii) of this section.

(iv) In the case of a loan held by a school, if the borrower's current address is unknown, the school attempts to locate the borrower and determine the borrower's potential eligibility for a discharge under this section by taking steps required to locate the borrower under § 674.44.

(v) If the borrower fails to submit the written request and sworn statement described in paragraph (g)(4) of this section within 60 days of the holder of the loan's mailing the discharge application, the holder of the loan resumes collection and grants forbearance of principal and interest for the period during which collection activity was suspended.

(vi) If the holder of the loan determines that a borrower who requests a discharge meets the qualifications for a discharge, the holder of the loan notifies the borrower in writing of that determination.

(vii) In the case of a loan held by the Secretary, if the Secretary determines that a borrower who requests a discharge does not meet the qualifications for a discharge, the Secretary notifies that borrower, in writing, of that determination and the reasons for the determination.

(viii) In the case of a loan held by a school, if the school determines that a borrower who requests a discharge does not meet the qualifications for discharge, the school submits that determination and all supporting materials to the Secretary for approval. The Secretary reviews the materials, makes an independent determination, and notifies the borrower in writing of the determination and the reasons for the determination.

(ix) In the case of a loan held by a school and discharged by either the school or the Secretary, the school must reimburse its Fund for the entire amount of any outstanding principal and interest on the loan, and any collection costs charged to the Fund as a result of collection efforts on a discharged loan. The school must also reimburse the borrower for any amount of principal, interest, late charges or collection costs the borrower paid on a loan discharged under this section.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0019)

11. Section 674.34 is amended by revising the section heading; revising paragraphs (a) and (c); and adding the Office of Management and Budget control number to read as follows:

§ 674.34 Deferment of repayment—Federal Perkins loans, Direct loans and Defense loans.

(a) The borrower may defer making a scheduled installment repayment on a Federal Perkins loan, a Direct loan, or a Defense loan, regardless of contrary provisions of the borrower's promissory note and regardless of the date the loan was made, during periods described in this section.

* * * * *

(c) The borrower of a Federal Perkins loan, a Direct loan, or a Defense loan need not repay principal, and interest does not accrue, for any period during which the borrower is engaged in service described in §§ 674.53, 674.54, 674.55, 674.56, 674.57, 674.58, 674.59, and 674.60.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0019)

12. Section 674.39 is revised to read as follows:

§ 674.39 Loan rehabilitation.

(a) Each institution must establish a loan rehabilitation program for all borrowers for the purpose of rehabilitating defaulted loans made under this part. The institution's loan rehabilitation program must provide that—

(1) A defaulted borrower is notified of the option and consequences of rehabilitating a loan; and

(2) A loan is rehabilitated if the borrower makes an on-time, monthly payment, as determined by the institution, each month for twelve consecutive months and the borrower requests rehabilitation; and

(3) A borrower who wishes to rehabilitate a loan on which a judgment has been entered must sign a new promissory note after rehabilitating the loan.

(b) Within 30 days of receiving the borrower's last on-time, consecutive, monthly payment, the institution must—

(1) Return the borrower to regular repayment status;

(2) Treat the first payment made under the 12 consecutive payments as the first payment under the 10-year repayment maximum; and

(3) Instruct any credit bureau to which the default was reported to remove the default from the borrower's credit history.

(c) Collection costs on a rehabilitated loan—

(1) If charged to the borrower, may not exceed 24 percent of the unpaid principal and accrued interest as of the date following application of the twelfth payment; and

(2) That exceed the amounts specified in paragraph (c)(1) of this section may be charged to an institution's Fund until July 1, 2002 in accordance with § 674.47(e)(5).

(d) After rehabilitating a defaulted loan and returning to regular repayment status, the borrower regains the balance of the benefits and privileges of the promissory note as applied prior to the borrower's default on the loan. Nothing in this paragraph prohibits an institution from offering the borrower flexible repayment options following the borrower's return to regular repayment status on a rehabilitated loan.

(e) The borrower may rehabilitate a defaulted loan only one time.

(Approved by the Office of Management and Budget under control number 1845–0019)

13. Section 674.41 is amended by adding a new paragraph (a)(3); and by

adding the Office of Management and Budget control number to read as follows:

§ 674.41 Due diligence—general requirements.

(a) * * *

* * * * *

(3) Provide the borrower with information on the availability of the Student Loan Ombudsman's office if the borrower disputes the terms of the loan in writing and the institution does not resolve the dispute.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0023).

14. Section 674.42 is amended by redesignating paragraph (b) as paragraph (c), revising paragraph (a), adding a new paragraph (b), and revising the Office of Management and Budget control number to read as follows:

§ 674.42 Contact with the borrower.

(a) *Disclosure of repayment information.* The institution must disclose the following information in a written statement provided to the borrower either shortly before the borrower ceases at least half-time study at the institution or during the exit interview. If the borrower enters the repayment period without the institution's knowledge, the institution must provide the required disclosures to the borrower in writing immediately upon discovering that the borrower has entered the repayment period. The institution must disclose the following information:

(1) The name and address of the institution to which the debt is owed and the name and address of the official or servicing agent to whom communications should be sent.

(2) The name and address of the party to which payments should be sent.

(3) The estimated balance owed by the borrower on the date on which the repayment period is scheduled to begin.

(4) The stated interest rate on the loan.

(5) The repayment schedule for all loans covered by the disclosure including the date the first installment payment is due, and the number, amount, and frequency of required payments.

(6) An explanation of any special options the borrower may have for loan consolidation or other refinancing of the loan, and a statement that the borrower has the right to prepay all or part of the loan at any time without penalty.

(7) A description of the charges imposed for failure of the borrower to pay all or part of an installment when due.

(8) A description of any charges that may be imposed as a consequence of default, such as liability for expenses reasonably incurred in attempts by the Secretary or the institution to collect on the loan.

(9) The total interest charges which the borrower will pay on the loan pursuant to the projected repayment schedule.

(10) A copy of the borrower's signed promissory note.

(b) *Exit interview.* (1) An institution must conduct exit counseling with each borrower either in person, by audiovisual presentation, or by interactive electronic means. The institution must conduct this counseling shortly before the borrower ceases at least half-time study at the institution. As an alternative, in the case of a student enrolled in a correspondence program or a study-abroad program that the school approves for credit, the school may provide written counseling materials by mail within 30 days after the borrower completes the program. If the borrower withdraws from school without the school's prior knowledge or fails to complete an exit counseling session as required, the school must provide exit counseling through either interactive electronic means or by mailing counseling material to the borrower at the borrower's last known address within 30 days after learning that the borrower has withdrawn from school or failed to complete exit counseling as required.

(2) In conducting the exit counseling, the school must—

(i) Inform the student as to the average anticipated monthly repayment amount based on the student's indebtedness or on the average indebtedness of students who have obtained Perkins loans for attendance at that school or in the borrower's program of study;

(ii) Review for the borrower available repayment options (*e.g.* loan consolidation and refinancing, including the consequences of consolidating a Federal Perkins Loan);

(iii) Suggest to the borrower debt-management strategies that the school determines would best assist repayment by the borrower;

(iv) Emphasize to the borrower the seriousness and importance of the repayment obligation the borrower is assuming;

(v) Describe in forceful terms the likely consequences of default, including adverse credit reports and litigation;

(vi) Emphasize that the borrower is obligated to repay the full amount of the loan even if the borrower has not completed the program, is unable to obtain employment upon completion, or is otherwise dissatisfied with or does not receive the educational or other services that the borrower purchased from the school;

(vii) Review with the borrower the conditions under which the borrower may defer repayment or obtain partial cancellation of a loan;

(viii) Require the borrower to provide corrections to the institution's records concerning name, address, social security number, references, and driver's license number, the borrower's expected permanent address, the address of the borrower's next of kin, as well as the name and address of the borrower's expected employer; and

(ix) Review with the borrower information on the availability of the Student Loan Ombudsman's office.

(3) Additional matters that the Secretary recommends that a school include in the exit counseling session or materials are in appendix D to 34 CFR part 668.

(4) An institution that conducts exit counseling through interactive electronic means must take reasonable steps to ensure that each student borrower receives the counseling materials and participates in and completes the exit counseling.

(5) The institution must maintain documentation substantiating the school's compliance with this section for each borrower.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0023)

15. Section 674.45 is amended by revising paragraph (b), by adding a new paragraph (h), and by revising the Office of Management and Budget control number to read as follows:

§ 674.45 Collection procedures.

* * * * *

(b)(1) An institution must report to any national credit bureau to which it reported the default, according to the reporting procedures of the national credit bureau, any changes to the account status of the loan.

(2) The institution must resolve, within 30 days of its receipt, any inquiry from any credit bureau that disputes the completeness or accuracy of information reported on the loan.

* * * * *

(h) As part of the collection activities provided for in this section, the institution must provide the borrower with information on the availability of the Student Loan Ombudsman's office.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0023)

16. Section 674.47 is amended by redesignating paragraphs (e)(5) and (e)(6) as (e)(6) and (e)(7), respectively, by adding new paragraph (e)(5), and by revising the Office of Management and Budget control number to read as follows:

§ 674.47 Costs chargeable to the Fund.

* * * * *

(e) * * *

(5) Until July 1, 2002 on loans rehabilitated pursuant to § 674.39, amounts that exceed the amounts specified in § 674.39(c)(1) but are less than—

(i) 30 percent if the loan was rehabilitated while in a first collection effort; or

(ii) 40 percent if the loan was rehabilitated while in a second collection effort.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0023)

17. Section 674.49 is amended as follows:

A. By redesignating paragraphs (f)(2)(ii)(A) and (f)(2)(ii)(B) as paragraphs (f)(2)(ii)(B) and (f)(2)(ii)(C), respectively; and adding a new paragraph (f)(2)(ii)(A).

B. By redesignating paragraphs (f)(3)(ii)(A) and (f)(3)(ii)(B) as paragraphs (f)(3)(ii)(B) and (f)(3)(ii)(C), respectively; and adding a new paragraph (f)(3)(ii)(A). By revising paragraphs (c)(1), (c)(2) and (c)(3);

C. Revising paragraph (e)(4)(i) introductory text; newly redesignated paragraphs (f)(2)(ii)(B) and (f)(3)(ii)(B); and paragraph (g).

D. By revising the Office of Management and Budget control number.

§ 674.49 Bankruptcy of borrower.

* * * * *

(c) * * *

(1) The institution must use due diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan. The institution must follow the procedures in this paragraph to respond to a complaint for a determination of dischargeability under 11 U.S.C. 523(a)(8) on the ground that repayment of the loan would impose an undue hardship on the borrower and his or her dependents, unless discharge would be more effectively opposed by avoiding that action.

(2) If the petition for relief in bankruptcy was filed before October 8, 1998 and more than seven years of the repayment period on the loan (excluding any applicable suspension of the repayment period defined in 34 CFR 682.402(m)) have passed before the borrower filed the petition, the institution may not oppose a determination of dischargeability requested under 11 U.S.C. 523(a)(8)(B) on the ground of undue hardship.

(3) In any other case, the institution must determine, on the basis of reasonably available information, whether repayment of the loan under either the current repayment schedule or any adjusted schedule authorized under subpart B or D of this part would impose an undue hardship on the borrower and his or her dependents.

* * * * *

(e) * * *

* * * * *

(4)(i) The institution must monitor the borrower's compliance with the requirements of the plan confirmed by the court. If the institution determines that the debtor has not made the payments required under the plan, or has filed a request for a ''hardship discharge'' under 11 U.S.C. 1328(b), the institution must determine from its own records and information derived from documents filed with the court—

* * * * *

(f) * * *

(2) * * *

(ii)(A) The petition for relief was filed before October 8, 1998;

(B) The loan entered the repayment period more than seven years (excluding any applicable suspension of the repayment period as defined by 34 CFR 682.402(m), and

* * * * *

(3) * * *

(ii)(A) The petition for relief was filed before October 8, 1998;

(B) The loan entered the repayment period more than seven years (excluding any application suspension of the repayment period as defined by 34 CFR 682.402(m) before the filing of the petition; and

* * * * *

(g) *Termination of collection and write-off.* (1) An institution must terminate all collection action and write off a loan if it receives a general order of discharge—

(i) In a bankruptcy in which the borrower filed for relief before October 8, 1998, if the loan entered the repayment period more than seven years (exclusive of any applicable suspension of the repayment period defined by 34 CFR 682.402(m)) from the date on which a petition for relief was filed; or

(ii) In any other case, a judgment that repayment of the debt would constitute an undue hardship and that the debt is therefore dischargeable.

(2) If an institution receives a repayment from a borrower after a loan has been discharged, it must deposit that payment in its Fund.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0023)

18. Section 674.52 is amended by revising paragraphs (c)(1) and (d); and by revising the Office of Management and Budget control number to read as follows:

§ 674.52 Cancellation procedures.

* * * * *

(c) *Cancellation of a defaulted loan.* (1) Except with regard to cancellation on account of the death or disability of the borrower, a borrower whose defaulted loan has not been accelerated may qualify for a cancellation by complying with the requirements of paragraph (a) of this section.

* * * * *

(d) *Concurrent deferment period.* The Secretary considers a Perkins Loan, Direct Loan or Defense Loan borrower's loan deferment under § 674.34(c) to run concurrently with any period for which cancellation under §§ 674.53, 674.54, 674.55, 674.56, 674.57, 674.58, 674.59, and 674.60 is granted.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0019)

19. Section 674.53 is amended by redesignating paragraphs (a)(2), (a)(3), (a)(4), (a)(5), and (a)(6) as (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7), respectively; by revising the heading of the section; by adding a new paragraph (a)(2); by revising paragraphs (a)(1), (b), and (c) to read as follows:

§ 674.53 Teacher cancellation—Federal Perkins, Direct and Defense loans.

(a) *Cancellation for full-time teaching in an elementary or secondary school serving low-income students.*

(1)(i) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins loan or a Direct loan made on or after July 23, 1992, for full-time teaching in a public or other nonprofit elementary or secondary school.

(ii) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992, for teaching service performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

(2) The borrower must be teaching full-time in a public or other nonprofit elementary or secondary school that—

(i) Is in a school district that qualified for funds, in that year, under title I of the Elementary and Secondary Education Act of 1965, as amended; and

(ii) Has been selected by the Secretary based on a determination that more than 30 percent of the school's total enrollment is made up of title I children.

* * * * *

(b) *Cancellation for full-time teaching in special education.* (1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins loan or Direct loan made on or after July 23, 1992, for the borrower's service as a full-time special education teacher of infants, toddlers, children, or youth with disabilities, in a public or other nonprofit elementary or secondary school system.

(2) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992, for teaching service performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

(c) *Cancellation for full-time teaching in fields of expertise.* (1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins loan or Direct loan made on or after July 23, 1992, for full-time teaching in mathematics, science, foreign languages, bilingual education, or any other field of expertise where the State education agency determines that there is a shortage of qualified teachers.

(2) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992, for teaching service performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

* * * * *

§ 674.54 [Removed and Reserved]

20. Section 674.54 is removed and reserved.

21. Section 674.56 is amended by revising the section heading and paragraphs (a), (b), and (c) to read as follows:

§ 674.56 Employment cancellation—Federal Perkins, Direct and Defense loans.

(a) *Cancellation for full-time employment as a nurse or medical technician.* (1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins or Direct loan made on or after July 23, 1992, for full-time employment as a nurse or medical technician providing health care services.

(2) An institution must cancel up to 100 percent of the outstanding balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992, for full-time service as a nurse or medical technician performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the borrower's promissory note.

(b) *Cancellation for full-time employment in a public or private nonprofit child or family service agency.* (1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins or Direct loan made on or after July 23, 1992, for service as a full-time employee in a public or private nonprofit child or family service agency who is providing, or supervising the provision of, services to high-risk children who are from low-income communities and the families of these children.

(2) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992, for employment in a child or family service agency on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

(c) *Cancellation for service as a qualified professional provider of early intervention services.* (1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins or Direct loan made on or after July 23, 1992, for the borrower's service as a full-time qualified professional provider of early intervention services in a public or other nonprofit program under public supervision by the lead agency as authorized in section 676(b)(9) of the Individual with Disabilities Act.

(2) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to July 23, 1992 for early intervention service performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

* * * * *

22. Section 674.57 is amended by redesignating paragraphs (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7) as (a)(3), (a)(4), (a)(5), (a)(6), (a)(7), and (a)(8), respectively; by revising the section heading and paragraph (a)(1); and adding a new paragraph (a)(2) to read as follows:

§ 674.57 Cancellation for law enforcement or corrections officer service—Federal Perkins, Direct and Defense loans.

(a)(1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Federal Perkins or Direct Loan made on or after November 29, 1990, for full-time service as a law enforcement or corrections officer for an eligible employing agency.

(2) An institution must cancel up to 100 percent of the outstanding loan balance on a Federal Perkins, Direct or Defense loan made prior to November 29, 1990, for law enforcement or correction officer service performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

* * * * *

23. Section 674.58 is amended by revising paragraph (a) to read as follows:

§ 674.58 Cancellation for service in a Head Start Program.

(a)(1) An institution must cancel up to 100 percent of the outstanding balance on a borrower's Direct or Federal Perkins loan, for service as a full-time staff member in a Head Start program.

(2) An institution must cancel up to 100 percent of the outstanding balance on a Defense loan for service as a full-time staff member in a Head Start program performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

(3) The Head Start program in which the borrower serves must operate for a complete academic year, or its equivalent.

(4) In order to qualify for cancellation, the borrower's salary may not exceed the salary of a comparable employee working in the local educational agency of the area served by the local Head Start program.

* * * * *

24. Section 674.60 is amended by revising the section heading and paragraph (a) to read as follows:

§ 674.60 Cancellation for volunteer service—Perkins loans, Direct loans and Defense loans.

(a)(1) An institution must cancel up to 70 percent of the outstanding balance on a Perkins loan, and 70 percent of the outstanding balance of an NDSL made on or after October 7, 1998, for service as a volunteer under The Peace Corps Act or The Domestic Volunteer Service Act of 1973 (ACTION programs).

(2) An institution must cancel up to 70 percent of the outstanding balance on a Direct or Defense loan for service as

a volunteer under The Peace Corps Act or The Domestic Volunteer Service Act of 1973 (ACTION programs) performed on or after October 7, 1998, if the cancellation benefits provided under this section are not included in the terms of the borrower's promissory note.

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§ 674.8, 674.10, 674.19, 674.20, 674.35, 674.36, 674.38,674.50, 674.61 [Amended]

25. Sections 674.8, 674.10, 674.19, 674.20, 674.35, 674.36, 674.38, 674.50, and 674.61 are amended by revising the Office of Management and Budget control number to read ''1845–0019''.

26. Sections 674.13 is amended by adding the Office of Management and Budget control number before the authority citation.

§ 674.13 Reimbursement to the Fund.

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(Approved by the Office of Management and Budget under control number 1845–0019)

27. Section 674.37 is amended by adding the Office of Management and Budget control number before the authority citation.

§ 674.37 Deferment of repayment—Direct loans made before October 1, 1980 and Defense loans.

* * * * *

(Approved by the Office of Management and Budget under control number 1845–0019)

§ 674.43, 674.48 [Amended]

28. Sections 674.43 and 674.48 are amended by revising the Office of Management and Budget control number to read ''1845–0023''.

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