UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

July 10, 2015

GEN-15-14

Subject: Repayment Agreements and Liability for Collection Costs on Federal Family Education Loan Program (FFELP) Loans

Summary: This letter restates the requirements for guaranty agencies regarding charging collection costs to FFELP borrowers who enter into repayment agreements

Dear Colleague:

In this letter we restate and clarify the rules that bar a guaranty agency from charging collection costs to a borrower who promptly after default enters into a repayment agreement, in particular a rehabilitation agreement, with that agency, and who honors that agreement.

A guaranty agency, after it pays a default claim and acquires the loan from the lender, is required to send an initial notice to the borrower. In that notice, the guaranty agency must give the borrower at least 60 days to take any of several actions, including entering into a repayment agreement with the guaranty agency. In this letter we refer to this step as the "notice and opportunity to resolve" the debt. A guaranty agency cannot charge collection costs to a defaulted borrower who, within the 60-day period following the initial notice, enters into a repayment agreement, including a rehabilitation agreement, and who honors that agreement.

These rules mirror how the Department treats those borrowers in its portfolio of FFELP and Direct Loans who enter into a repayment agreement during the initial notice and opportunity to resolve period for that borrower and honor that agreement. Few borrowers in the Department's portfolio enter into repayment within that initial period.

Applicable provisions of the Higher Education Act

Section 484A(a) of the Higher Education Act of 1965, as amended (HEA), provides that defaulted borrowers "shall be required to pay, in addition to other charges specified in this subchapter . . . reasonable collection costs." Section 428F(a) of the HEA requires the guarantor to offer the borrower an opportunity to have a defaulted loan "rehabilitated," and the default status cured, by making nine timely payments over 10 consecutive months, after which the loan may be sold to a FFELP lender or assigned to the Department, and the record of default as reported by the guarantor is removed from the borrower's credit history. Under the HEA and the Department's regulations, the installment amounts payable under a rehabilitation agreement must be "reasonable and affordable based on the borrower's total financial circumstances."

Applicable provisions of Department regulations

The regulations direct the guarantor to charge the borrower "reasonable" collection costs incurred to collect the loan. 34 C.F.R. 682.410(b)(2). Generally, the charges cannot exceed the lesser of the amount the borrower would be charged as calculated under 34 C.F.R. 30.60 or the amount the Department would charge if the Department held the loan. However, there is an exception, discussed later, for collection costs charged in connection with loan rehabilitation. 34 C.F.R. 682.410(b)(2), citing 34 C.F.R. 682.405(b)(1)(vi)(B). Before the guarantor reports the default to a credit bureau or assesses collection costs against a borrower, the guarantor must provide the borrower written notice that explains the nature of the debt, and the borrower's right to request an independent administrative review of the enforceability or past-due status of the loan and to enter into a repayment agreement for the debt on terms satisfactory to the guarantor. 34 C.F.R. 682.410(b)(5)(ii).

The regulations also provide that the reasonable and affordable payment required under a rehabilitation agreement must generally be an amount equal to 15 percent of the amount by which the borrower's adjusted gross income exceeds 150 percent of the poverty guideline amount applicable to the borrower's family size and State, divided by 12. 34 C.F.R. 682.405(b)(1)(iii). If the borrower objects to that proposed monthly payment amount, the guaranty agency must offer a reasonable and affordable payment amount based on the borrower's individual financial circumstances. 34 C.F.R. 682.405(b)(1)(vii). The guarantor must disclose to the borrower who seeks rehabilitation of a loan, among other matters, the amount of any collection costs to be added to the unpaid principal at the time of sale of the loan to a lender, which amount cannot exceed, currently, 16 percent of the unpaid principal and accrued interest at the time of sale. Section 428F(1)(D)(i)(II)(aa) of the HEA, 20 U.S.C. 1078-6(1)(D)(i)(II)(aa).[1]

<u>Background and rationale for the requirement to provide an initial "notice and opportunity to resolve" the debt</u>

This section describes the context in which the Department adopted regulations requiring a guarantor to provide a borrower with this notice and opportunity to resolve a defaulted loan. Section 430A of the HEA requires guarantors and the Department, prior to reporting to a credit bureau that the loan is in default, to provide the borrower with notice that the loan will be reported as in default status "unless the borrower enters into repayment," and requires the default to be reported "if the borrower has not entered into repayment within a reasonable time, but not less than 30 days from the date of the notice. . ." 20 U.S.C. 1080a(c)(4). In 1992, the Department adopted a regulation which requires the guarantor, "before it reports the default to a credit bureau or assesses collection costs against a borrower," to provide the borrower an initial opportunity to challenge the enforceability or past-due status of the loan, to obtain an independent review of that challenge, to access the related records, and to agree to voluntary repayment. 34 C.F.R. 682.410(b)(5), 57 FR 60280, 60355-56 (December 18, 1992). The regulation uses the future tense in describing those actions that the guarantor may take to collect the debt, after providing the required notice: "costs <u>will be charged</u>," and "the agency <u>will report the default</u> to credit bureaus." 34 C.F.R. 682.410(b)(5)(vi)(E), (F) (emphasis added).

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[1] For sales prior to July 1, 2014, the maximum rate was 18.5 percent. That rate was reduced to 16 percent by section 501 of Pub. L. 113-67, Dec. 26, 2013. That change has not yet been reflected in the Department's regulations.

In adopting the FFELP regulation in 1992, the Department expressly considered guaranty agencies' years of experience under the Federal tax refund offset program. Since 1984, the Department had been authorized to refer defaulted student loan debts to the Department of the Treasury for collection by offset against tax refunds owed to defaulted borrowers. 26 U.S.C. 6402(d), 31 U.S.C. 3720A. In 1986, the Department adopted regulations to establish the procedures for referring defaulted debt, which include giving the debtor notice of the proposed offset and an opportunity to avoid the offset by entering into a satisfactory repayment agreement. 34 C.F.R. 30.33, 51 FR 24092, 24095 (July 1, 1986). In adopting this offset rule, the Secretary made clear that the Department would use the guaranty agencies to perform certain functions on its behalf in order to collect those defaulted, federally reinsured loans held by guaranty agencies: sending the required pre-offset notice to the borrower, conducting an initial review if requested by the borrower, and providing the borrower an opportunity to avoid offset by making a timely agreement to repay the loan. 51 FR 24095, 24096 (July 1, 1986).

In 1992, the Department required a guaranty agency to provide the borrower an initial notice and opportunity to resolve the debt in all circumstances, not just for offset purposes, 57 FR 60280, 60356 (Dec. 18, 1992). Noting that guaranty agencies had experience with notice and opportunity because of their participation in the refund offset program, 57 FR 60280, 60312 (Dec. 18, 1992), the Department in these 1992 regulations provided that a guaranty agency would meet the new requirement by following those pre-offset rules: "the administrative offset procedures set forth at 34 C.F.R. 30.20 – 30.33 satisfy the requirements" that the guarantor must meet "before [the guarantor] reports the default to a credit reporting agency or assesses collection costs." 34 C.F.R. 682.410(b)(5)(iii). Thus, by pointing to the offset procedure as a model for the overall FFELP notice and opportunity to resolve rule, the Department showed that it intended the new FFELP rule to follow the same offset rules: the borrower could avoid the adverse consequences (report of the default status of the debt, liability for collection costs, and further collection actions) by making a timely agreement to repay the debt voluntarily.

Background and rationale for the requirement to charge collection costs

The 1992 final rule also required the guarantor, for the first time, to charge collection costs. 34 C.F.R. 682.410(b)(2); 57 FR 60280, 60355 (Dec. 18, 1992). In this rule the Department interpreted the statutory term "reasonable collection costs" in section 484A(b) of the HEA by capping the collections at the lesser of the actual costs incurred by the guarantor under a "make whole" formula in 34 C.F.R. 30.60, or the rate the Department would charge if it held the loan. As the Department explained in briefs and in the testimony of responsible Department officials in Education Credit Management Corp. v. Barnes, 318 B.R. 482 (S.D. Ind. 2004), aff'd, 459 F.3d 796 (7th Cir. 2006), claims for repayment of defaulted, federally reinsured FFELP loans are claims of the United States, and, accordingly, Department rules for their collection conform with the Federal Claims Collection Standards (FCCS).[2] At the time of the 1992 Department's collection costs rule, the FCCS directed Federal agencies to charge delinquent debtors the costs of collection, which an agency was to determine based "upon cost analyses establishing an

[2] The Department recognized the applicability of the FCCS to FFELP regulations in 1992 in issuing the FFELP collection costs regulation and again in 1996, in regulating the manner in which payments must be applied by the guaranty agency. 61 FR 60482 (Nov. 27, 1996).

average of actual additional costs incurred by the agency in processing and handling claims against other debtors in similar stages of delinquency." 4 C.F.R. 102.13(d)(1992) (emphasis added).[3]

In response to this government-wide directive, the Department adopted a regulation which distinguishes between defaulted borrowers who agree promptly to repay – within the 60-day resolution period – from those defaulters who do not immediately cooperate and for whom the guarantor may incur significant costs to pursue. Consistent with the Department's long-standing practice and with its interpretation of the HEA provisions, the FFELP regulation treats the two groups as in "different stages of delinquency" from the FCCS perspective, and directs that costs be charged only to the second group. The Department stated this position in response to an inquiry from a guarantor in 1997.[4]

Thus, the regulations direct the guaranty agency to charge the borrower collection costs - but only after the guaranty agency provides borrower the opportunity to dispute the debt, to obtain review the objection, and to agree to repay the debt on terms satisfactory to the guarantor. If the borrower agrees within that initial period to repay the debt under terms satisfactory to the guarantor and consistent with the requirements, the borrower cannot be charged collection costs at any time thereafter unless the borrower later fails to honor that agreement.[5] In determining whether those costs are reasonable and properly charged to a borrower who timely agrees to repay and honors that agreement, it is irrelevant whether the guaranty agency uses its own staff to provide the notice and opportunity to resolve or contracts for those services.

Background and rationale for the requirement to offer loan rehabilitation

In June 1994, the Department adopted a regulation to implement the loan rehabilitation provisions in section 428F(a) of the HEA (20 U.S.C. 1078-6(a)). 34 C.F.R. 682.405, 59 FR 33334, 33335 (June 28, 1994). To have a defaulted loan rehabilitated, a borrower must request rehabilitation and voluntarily make nine out of 10 monthly payments in the amount determined

[3] In describing the kinds of differences between groups of borrowers that would warrant differing charges, the General Accounting Office and the Justice Department distinguished in the FCCS between those costs incurred by the agency "in any event" in handling the debt, and those incurred "by virtue of the delinquency." 49 FR 8893 (March 9, 1984). Examples of costs incurred "by virtue of the delinquency" included the costs of hiring additional personnel and retaining private debt collectors to pursue recovery from those who do not respond to the routine initial demand by the agency. Id. FFELP regulations permit a lender to charge collection costs, but bar the lender from charging for costs of such routine activities as preparing notices and making contact with the borrower. 34 C.F.R. 682.202(f)(2). The Department or the guaranty agency, as applicable, must notify the borrower if it acquires a loan. The cost of doing so, and of responding to the initial notice in which this would be communicated, was expected to be minimal--more akin to the cost of servicing activities that lenders routinely conduct, such as considering requests for forbearances, deferments, or income-based repayment terms - costs which lenders must defray from interest earnings on their portfolio - than to the significant expenses in hiring additional staff or retaining private debt collectors to pursue those borrowers who do not promptly agree to repay.

[4] Letter from Ronald Streets, Program Specialist, Student Financial Assistance Programs, Department of Education, to Phillip Cervin, Asst. Vice President, Texas Guaranteed Student Loan Corporation (July 28, 1997).

[5] 34 C.F.R. 682.404(f) does not require or authorize the guarantor to charge the defaulter collection costs, but simply directs the order in which a payment must be applied to a loan on which those costs are properly charged. Thus, if there are no late charges owed on the loan, §682.404 does not authorize the guarantor to charge late fees simply by mentioning the order in which any late fees properly imposed are to be satisfied.

by the guarantor in a written installment payment agreement. Thus, a rehabilitation agreement is simply a specific form of a satisfactory repayment agreement.

The Department's loan rehabilitation regulations require that the guarantor explain to the borrower the terms of the rehabilitation agreement or arrangement, including "the amount of the collection costs to be added to the unpaid principal at the time of the sale [which] may not exceed 18.5 percent of the unpaid principal and accrued interest at the time of sale." 34 C.F.R. 682.405(b)(1)(iv) (1994).[6] As explained in a Departmental Dear Guaranty Agency letter on March 29, 1994, the Department did not adopt the (original) 18.5 percent regulatory "cap" on the collection costs charged at the time of sale in order to give guarantors authority to charge such costs, but rather to limit the amount that a guarantor could charge – at the time of the sale – to those borrowers who were already liable for collection costs under existing authority. The change was needed because, at that time, the maximum collection costs rate that was permitted on borrower payments generally was the rate then charged (on routine recoveries) by the Department, which was "sometimes as high as 43 percent of the outstanding principal and interest on the defaulted loan."[7] The Department "concluded that the amount of collection costs currently assessed borrowers as reasonable under 34 C.F.R. 682.410(b)(2) is not reasonable when the borrower has shown the initiative to address the default through [rehabilitation]."[8]

Nothing in the 1994 rehabilitation regulations exempts loan rehabilitation transactions from the general rule that allows a guarantor to charge collection costs only to a borrower who fails to enter into a repayment agreement satisfactory to the agency within the 60-day period following the initial notice and opportunity to resolve. The loan rehabilitation agreement with the borrower is clearly a "repayment agreement."[9] Moreover, the loan rehabilitation agreement is an agreement on terms that the guaranty agency must accept as satisfactory to the agency. Thus, a guaranty agency cannot use the collection activities otherwise required if a borrower, in this initial period, enters into a rehabilitation agreement and then honors that agreement.[10]

[6] As noted earlier, this rate was reduced to 16 percent by 2013 amendments.

[7] Dear Guaranty Agency Director Letter, March 29, 1994, at 2.

[8] Id. In March 1995, the Department reduced that charge to no more than 25 percent of the portion of the particular payment that is applied to principal and interest; the amount used to defray costs thus equals 20 percent of the total amount of the payment. Since that 1995 change, the "cap" has not exceeded that rate of 20 percent of the gross amount of the payment.

[9] See: 34 C.F.R. 682.405(a)(2)(i) and (b)(1), which refer to the "rehabilitation agreement" as a "monthly repayment agreement."

[10] The regulation states that to avoid credit reporting as in default and collection action, the borrower must enter into "a repayment agreement on terms satisfactory to the agency," 34 C.F.R. 682.410(b)(5)(ii)(D). The context makes clear that a rehabilitation agreement is such a "satisfactory" repayment agreement. First, 34 C.F.R. 682.410(b)(6) requires the guarantor to take specific collection action - garnishment and offset - if the borrower fails to timely enter into an "acceptable" repayment agreement. Section 488A of the HEA allows a guarantor to collect the debt by garnishment only if the borrower is "not currently making payments under a repayment agreement with . . . the guaranty agency," 20 U.S.C. §1095a(a) (emphasis added). The guarantor, further, may not even start garnishment for a borrower who "requests rehabilitation." 78 FR 45636 (July 29, 2013). Similarly, 31 U.S.C. §3720A permits collection by offset only of "past-due, legally-enforceable debt," allows the borrower to object to offset on the ground that the debt is not "past-due," 31 U.S.C. §3720A(b)(2), and requires the creditor agency to affirmatively determine that the debt is "past-due." 31 U.S.C. §3720A(b)(3). A "past-due" debt is a debt not paid by the date

The charging of collection costs upon completion of a loan rehabilitation by the sale or assignment of the loan was first addressed in the 2006 amendment to section 428F to the HEA. Those amendments provided that the guaranty agency "may in order to defray collection costs, charge the borrower an amount not to exceed 18.5 percent of the outstanding principal and interest at the time of the loan sale, and retain such amount from the proceeds of the loan sale." 20 U.S.C. 1078-6 as amended by the Higher Education Reconciliation Act of 2005 (HERA), P.L. 109-171, section 8014(h), February 8, 2006. The legislative history of this change shows that the amendment was intended to codify "the collection costs permissible for rehabilitated loans at up to 18.5 percent of the outstanding principal and interest of the loan." H.R. Rep. No. 276, 109th Cong. 1st Sess. (2005) at 240. Existing Department regulations had already established which costs were permissible; because the amendment simply "codified" the permissible costs, the amendment did not empower a guarantor to charge costs that were not already permitted under the regulations. The Department promptly recognized that this 2006 amendment simply "codified" those permitted costs, rather than superseding existing regulatory limits on collection costs. In Dear Colleague Letter Gen 06-02, issued March 2006, the Department characterized the HERA amendment not as granting "authority" to charge costs, but rather as merely "specifying" the limits to that existing authority as those already contained in the regulation.

Conclusion

Department regulations bar a guaranty agency from charging collection costs to a defaulted borrower who responds within 60 days to the initial notice provided by the guaranty agency, enters into a repayment agreement, including a rehabilitation agreement, and who honors that agreement. This includes, in the case of loan rehabilitation, both collection costs on the initial and subsequent qualifying payments and collection costs upon the ultimate sale or assignment of the loan. For defaulters who do not enter into a repayment agreement, guaranty agencies can and should charge collection costs.

Thank you for your cooperation.

Sincerely,

Lynn B. Mahaffie
Deputy Assistant Secretary for
Policy, Planning, and Innovation
Office of Postsecondary Education

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specified, as pertinent here, in the "applicable agreement" "including a post-delinquency payment agreement." 31 C.F.R. 285.5(b). The guarantor cannot proceed to collect by offset or garnishment any debt already being repaid under any "post-delinquency payment agreement." Therefore, 34 C.F.R. 682.410(b)(6) must be read, in context, to require the guarantor to pursue such collection actions <u>only</u> against a borrower who fails to timely enter into, and to honor, <u>any</u> form of repayment agreement, including a rehabilitation agreement.