Preparing for Reauthorization in Default Management

By Mary Lyn Hammer, Hands On, Inc.

While the Higher Education Amendments (HEA) of 1998 have been passed, Negotiated Rulemaking for the amendments is targeted for the near future. Schools would be well advised to anticipate and participate in some of the issues that will affect student loan management and future default rates.

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Several issues that can directly effect loan management programs are the inclusion of (1) automatic assignment of a five year repayment schedule for borrowers who do not choose a repayment schedule option during the grace period; (2) unemployment benefit recipients automatic qualification for Unemployment Deferments; (3) the use of Master Loan Application form for all of a borrower's loans, and (4) collection of data regarding the decrease of the definition of a rehabilitated loan from 12 months of consecutive, on-time payments to six months.

First, current wording for repayment plans states that, "No plan may require a borrower to repay a loan in less than five years unless the borrower, during the six months immediately preceding the start of the repayment period, specifically requests that the repayment be made over a shorter period." Inclusion of this exact wording without being tied to a clause stating "or a minimum payment in excess of the monthly interest accrual" could possibly put a borrower with a low loan balance in a negative amortization schedule. This would adversely affect the borrower financially and would have a negative affect on the school's default rate should the negative repayment continue for more than 270 consecutive days. Officials at the Department have "noted" the problem, but schools should closely watch the upcoming NPRM's to ensure that wording includes "minimum payment requirements".

Second, borrowers who have qualified for unemployment benefits will be able to attach a copy of the written confirmation of benefits to an Unemployment Deferment form in order to be approved for the deferment. Currently, officials at the Department have not designed this form, but say that current plans are that it will be a separate form from the existing Unemployment Deferment form. We suggest that one form be used for all Unemployment Deferment benefits and also be used for both FEEL and Direct Loan Programs.

Third, the use of a "Master Promissory Note" is appealing to the Financial Aid Department, but could lead to servicing problems in the future if the loans are not tracked and

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sold to the same entity. Current wording allows the loans on one note to "be sold or assigned independently of one another" and does not include wording that would ensure that the borrower ultimately have one holder and servicer. Schools should monitor and make suggestions for wording on this issue because borrowers with multiple payments are a higher risk for default.

Fourth, the reduction of the number of regular, timely payments on defaulted loans from 12 to six months can greatly help schools with their default rates because it gives them more opportunity to rehabilitate the loans and remove the defaulted loans from their cohort default rates. While the HEA of 1998 require guarantors to collect and report on these rehabilitated loans, there is no legislation to utilize the information.

Because rehabilitation assistance will not only help your borrowers, but can also lower your default rate if the borrower makes the required payments prior to the end of a cohort cycle, schools should encourage defaulted borrowers to make these payments and should track the results to present to the Department and Congress for inclusion in a future reauthorization. Don't rely on the guarantors to do this for you - to them it is more work, but to you it can mean lower default rates.

The final wording on these issues can greatly help or hinder your school's ability to help borrowers. Please take an active part in providing helpful information to Department officials during the Negotiated Rulemaking process to ensure that final wording in Federal Regulations is a help, not a hindrance, to your school and its borrowers!

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