

Default in the Federal Perkins Loan Program is defined as “the failure of a borrower to make an installment payment when due or to comply with other terms of the promissory note or written repayment agreement.”

Chapter 7 discussed options that schools may offer borrowers to resolve default and avoid litigation, such as waiver of collection costs, compromise of repayment, and consolidation. This chapter discusses rehabilitation, another method to resolve default. This chapter also details how schools must manage and report defaulted loans and, if necessary, assign them to the Department.

DEFAULT STATUS AND STUDENT ELIGIBILITY

Satisfactory repayment arrangements

A borrower who is in default on a Perkins Loan may regain eligibility for further federal student aid by making satisfactory repayment arrangements. (See *Volume 1 - Student Eligibility*.) If the borrower has made satisfactory repayment arrangements, the school must appropriately update the loan status code in the National Student Loan Data System.

Loans with judgments

When a school has filed suit to collect a defaulted Perkins Loan or NDSL and a judgment has been rendered on the loan, the borrower is obligated to repay only the amount of the judgment obtained on the loan. After a judgment is satisfied on the defaulted loan, the student is again eligible for aid from Federal Student Aid (FSA) programs if all other eligibility criteria are met. However, if a borrower has previously satisfied a defaulted student loan **involuntarily** (for instance, through wage garnishment), you should consider this as evidence of unwillingness to repay and should not approve further loan assistance to the borrower.

Previously defaulted loans discharged for school closure

A Perkins Loan made on or after January 1, 1986, may be discharged if the borrower is unable to complete his or her program

Closed school discharge cite
34 CFR 674.33(g)

of study due to the closure of the school that made the loan. A defaulted borrower whose loan is discharged under this closed school provision is eligible for additional federal student aid, provided that he or she meets all other eligibility criteria. (Schools that close must assign all Perkins Loans to the FSA Collections. FSA Collections, or the school, if the school still holds the loan, must report to credit bureaus that the loan has been discharged.)

LOAN REHABILITATION

Rehabilitation cite

34 CFR 674.39

A borrower may rehabilitate a defaulted Perkins Loan by making 12 consecutive on-time payments. Your school must establish a rehabilitation program and notify all borrowers with defaulted loans of the option to rehabilitate and the advantages of rehabilitation.

The rehabilitation payments should be sufficient to satisfy the outstanding balance on the loan within a 10-year repayment period.

If a judgment has been entered on the loan, the borrower must sign a new promissory note after making the 12 required payments.

Within 30 days of receiving the borrower's last on-time consecutive monthly payment, you must:

- return the borrower to regular repayment status;
- treat the first of the 12 consecutive payments as the first payment in a new 10-year repayment schedule; and
- instruct any credit bureau to which the default was reported to remove the default from the borrower's credit history.

After rehabilitating a defaulted loan and returning to regular repayment status, a borrower regains the benefits and privileges of the promissory note, including deferment and cancellation.

If a borrower chooses to rehabilitate a defaulted loan and then fails to make 12 consecutive on-time payments, the rehabilitation is unsuccessful, but the borrower may still make further attempts to rehabilitate the defaulted loan. Also, if a borrower successfully rehabilitates a defaulted loan and maintains good standing on the loan, the borrower may continue to attempt to rehabilitate other defaulted Perkins loans. However, if the borrower successfully rehabilitates a defaulted loan, but the loan later returns to default, the borrower may not attempt to rehabilitate that loan again or any other defaulted Perkins loan.

See chapter 7 for information on assessing collection costs on rehabilitated loans.

ASSIGNMENT

You may assign a defaulted Perkins Loan or NDSL to the FSA Collections if:

- the school has not been able to collect despite having followed due diligence procedures (including at least a first level of collection and litigation, if required by the regulations in effect on the date the loan entered default);
- the total amount of the borrower's account to be assigned, including outstanding principal, accrued interest, collection costs, and late charges, is \$25 or more; and
- the loan has been accelerated.

Your school must assign to FSA Collections all its Perkins and NDSL loans if:

- the school is closing;
- the school is withdrawing from the Federal Perkins Loan Program; or
- the Department is terminating the school's participation in the program.

A loan may be assigned only during the submission period the Department establishes.

Required documentation

A school *may be required* to submit the following documents to FSA Collections for any loan it proposes to assign:

- one original and one photocopy of the assignment form—ED Form 553, provided by the Department and completed by the school (the form must include the borrower's Social Security Number);
- the original promissory note or a certified copy of the original note;
- a copy of the repayment schedule and a complete statement of the payment history;
- copies of all approved requests for deferment and cancellation; a copy of the notice to the borrower of the effective date of acceleration and the total amount due on the loan;
- documentation that the school has withdrawn the loan from any firm that it employed for address search, billing, collection, or litigation services and has notified that firm to cease collection activity on the loans;
- copies of all pleadings filed or received by the school on behalf of a borrower who has filed a petition in bankruptcy

Assignment cites

34 CFR 674.50

Dear Colleague Letter CB-98-13 and CB-98-14

Assignment address

A school should mail assignments to:

U.S. Department of Education
Perkins Loan Assignment
Processing Center
P.O. Box 4136
Greenville, TX 75403-4136

Perkins loan liquidation procedures cite

Dear Partner Letter CB-00-05, dated May 2000

and whose loan obligation is determined to be nondischargeable;

- a certified copy of any judgment order entered on the loan; and
- documentation that the school has complied with all of the due diligence requirements if the school has a cohort default rate that is equal to or greater than 20% as of June 30 of the second year preceding the submission period.

You may not assign a loan to FSA Collections if:

- the borrower has received a discharge in bankruptcy—unless the bankruptcy court has determined that the student loan obligation is nondischargeable and has entered a judgment against the borrower or unless a court of competent jurisdiction has entered judgment against the borrower on the loan after the entry of the discharge order;
- your school has sued the borrower (unless the judgment has been entered and assigned to the United States); or
- the loan has been canceled because the borrower has died.

Terms of assignment

If FSA Collections accepts the assignment of a loan, it will give the school written notice to that effect. **By accepting the assignment, the Department acquires all rights, title, and interest in the loan.** You must endorse and forward to the Department any subsequent payment(s) the borrower may make.

If FSA Collections later determines an assigned loan to be unenforceable because of an act or omission on the part of your school or its agent, your school will have to compensate the Perkins Loan Fund in the amount of the unenforceable portion of the outstanding balance. Once the fund is reimbursed, the Department transfers all rights to the loan back to the school.

A borrower whose loan has been assigned to the United States for collection continues to be in default on the loan and is ineligible for FSA funds until the borrower provides confirmation from FSA Collections that he or she has made satisfactory arrangements to repay the loan.

DEFAULT REDUCTION ASSISTANCE PROJECT

To assist schools in bringing defaulted borrowers into repayment, the Department has established the Default Reduction Assistance Project (DRAP). Under DRAP, a school can request that the Department send a borrower any of three letters designed to warn the student of the seriousness of default. The Department provides these services at no cost to the school. Participation in DRAP is voluntary.

Default reduction assistance project cite

Dear Colleague Letter CB-94-7

Perkins Default Cohort Periods



General questions about DRAP should be directed to the Campus-Based Call Center at 1-877-801-7168. As DRAP is intended to get the borrower back into repayment **before** the account goes to a collection firm, this service should **not** be requested once a collection agency is involved. DRAP service is usually provided during the 30-day period during which a school is awaiting response to the final demand letter.

PERKINS COHORT DEFAULT RATES

Defining and calculating the cohort default rate

Your school's cohort default rate is calculated for a particular year based on information you report in Part 3, Sections D and E of the FISAP.

For any award year in which 30 or more borrowers enter repayment, the **cohort default rate** is the percentage of those current and former students who enter repayment in that award year on loans received for attendance at that school and who default before the end of the following award year.

For any award year in which **fewer** than 30 current and former students at the school enter repayment on a loan received at the school, the **cohort default rate** is the percentage of those current and former students who entered repayment on loans received for attendance at that school in any of the **three** most recent award years and who defaulted on those loans before the end of the award year immediately following the year in which they entered repayment.

Borrowers entering repayment

For purposes of the cohort default rate, a loan enters repayment only once in its life. This repayment begins the day after the end of the initial grace period or the day that the borrower waives his or her initial grace period.

Borrowers in default

A borrower must be included in determining the school's cohort default rate if the borrower's default has persisted for at least 240 consecutive days for a loan repayable monthly or 270 consecutive days for a loan repayable quarterly.

Calculating cohort default rate cite

34 CFR 674.5(b)

Calculating cohort default rate example

During the 2000-2001 award year, more than 30 borrowers entered repayment at Justinian University. For the Fiscal Operations Report for 2001-2002 and Application to Participate for 2003-2004 (FISAP), Justinian University calculates its cohort default rate in Section D of the FISAP.

DENOMINATOR: Justinian University determines that **500** students entered repayment in the 2000-2001 award year.

NUMERATOR: Justinian University determines that, of the 500 students who entered repayment in the 2000-2001 award year, **10** defaulted by the end of the 2001-2002 award year (June 30, 2002).

Justinian University divides the numerator by the denominator and multiplies by 100:

$$\begin{aligned} \text{Cohort default rate} &= \frac{10}{500} \times 100 \\ &= 2\% \end{aligned}$$

In default cite

34 CFR 674.5(c)

240/270-day delinquency example

If a borrower's loan is in default for at least 240/270 consecutive days and an authorized period of deferment begins after the 239th day past due, the loan would be counted as a default in the school's cohort default rate even if the loan is in a deferred status on June 30.

A loan is still considered in default if the school, its owner, agency, contractor, employee, or any other entity or individual affiliated with the school makes a payment to prevent the borrower from defaulting.

In the case of a student who has attended and borrowed at more than one school, the student and his or her subsequent repayment or default are attributed to the school where the student received the respective loan.

A defaulted loan that has been assigned to the Department is counted in determining a school's cohort default rate if the loan entered repayment during the appropriate time period. Assignments of loans to the Department no longer lower a school's default rate. In addition, the status of a loan that has been assigned to the Department is still considered in default until the loan is paid in full, *even if the borrower has made satisfactory arrangements* to repay the defaulted loan in order to qualify for additional aid from FSA programs.

Loan not included in cohort default rate

The following loans are not treated as defaults in calculating schools' Federal Perkins Loan Program cohort default rates:

- loans on which borrowers have made six consecutive monthly payments;
- loans on which borrowers have “voluntarily¹” made all payments currently due;
- loans that borrowers have repaid in full;
- loans for which borrowers have received deferments or forbearance based on conditions that began prior to loans becoming 240/270 days past due;
- loans that have been rehabilitated;
- loans repaid in full under a compromise repayment agreement in accordance with 674.33(e); and
- loans that have been discharged due to death or permanent disability, bankruptcy, or a school closing, and
- loans that have been assigned to the Department for determination of eligibility for total and permanent disability discharge.

Rules for calculating the number of days in default

The following rules are used in calculating the number of days a loan has been in default:

- The 240/270 consecutive days in default is determined by calculating the “age” of the account (that is, the number of consecutive days the oldest dollar is past due).

Loans not included cite

34 CFR 674.5(c)(3)

1. The term “voluntarily” excludes payments obtained by income tax offset, garnishment, income asset execution, or pursuant to a judgment.

- A payment that a borrower makes on a past-due loan is applied to the oldest dollars first, effectively reducing the past-due status.
- A loan on which a borrower is past due and on which the borrower makes an occasional payment but never becomes current could be counted as a defaulted loan for the cohort default rate calculation despite the occasional payments. Because the delinquency is not being cured, the oldest past-due dollar could eventually become 240 days past due, making the loan count in the cohort default rate calculation. However, if the borrower makes enough occasional payments to prevent the oldest past-due dollar from becoming 240 days old, the loan would not be included in the cohort default rate calculation.
- An exception to the 240/270-day threshold will be granted in a case where a borrower (1) would have qualified for a deferment for a period beginning prior to the loan hitting the 240/270-day threshold and (2) failed to file a request for the deferment in a timely manner.

For such a borrower, the loan's past-due status would be adjusted to reflect the deferment period beginning date. However, the borrower would need to pay any past-due amounts that were due prior to the beginning of the authorized deferment periods, if the deferment period beginning date does not eliminate the loan's entire delinquency.

PENALTIES FOR HIGH COHORT DEFAULT RATES

If the school's cohort default rate is 25% or higher, the school's FCC will be reduced to zero.

Beginning with the 2000-2001 award year, a school with a cohort default rate of 50% or more for the three most recent years is ineligible to participate in the Federal Perkins Loan Program and must liquidate its loan portfolio.

A school may appeal a determination of ineligibility if the appeal is based on an inaccurate calculation of its cohort default rate or a low number of borrowers entering repayment. A school appeals a determination of ineligibility based on an inaccurate calculation by adjusting the cohort default rate data on the FISAP.

Applying payment to oldest dollars first example

Johnny's monthly payment amount is \$50. He has made no payments for five months, making the loan 150 days past due. Johnny then makes one \$50 payment. Caravello College applies the payment to cover the first month's payment that was overdue, reducing the loan's past-due status from 150 days to 120 days because the earliest past-due payment is now four months old. The calculation of the number of days overdue begins with the oldest dollar past due.

Occasional payment/never becoming current example

Kelly's oldest dollar is 120 days past due. She does not make any additional payments for 90 days, making the oldest dollar 210 days past due. Kelly then makes a \$50 payment, reducing the past-due status to 180 days. Another 60 days elapse without Kelly making a payment, bringing the oldest dollar to 240 days past due. At that point, the loan would be counted in the school's cohort default rate even if subsequent payments reduce the past-due status to less than 240 days.

Adjusting past-due status example

Marty's oldest dollar is 240 days past due. He files a request for a deferment based on the fact that he is attending school and the enrollment period began on the date that the loan became 90 days past due. The past-due status of the loan is reduced to 90 days, and the loan is given a deferment status. This loan is treated as if the 240-day threshold had never been reached. Therefore, it would not be counted in the school's cohort default rate.

Penalty cite

34 CFR 674.5(a)

Cohort Default Rate for multiple locations or change of ownership

If a school has a branch or branches or has an additional location or locations, the school's cohort default rate applies to all branches and locations of the school as they exist on the first day of the award year for which the rate is calculated. The cohort default rate applies to all branches/locations of the school from the date the Department notifies the school of the rate until the Department notifies the school that the rate no longer applies.

If a school changes status from a branch of one school to a freestanding or independent school, the Department determines the cohort default rate based on the school's status as of July 1 of the award year for which the rate is being calculated.

If an independent school becomes a branch of another school or merges with another independent school, the Department determines the cohort default rate based on the combined number of students from both schools who enter repayment during the applicable award year and the combined number of students from both schools who default during the applicable award years. The new rate applies to the new consolidated school and all of its current locations.

If a school changes status from a branch of one school to a branch of another school, the Department determines the cohort default rate based on the combined number of students from both schools who enter repayment during the applicable award year and the combined number of students from both schools who default during the applicable award years from both schools in their entirety.

If a school has a change in ownership that results in a change in control, the Department determines the cohort default rate based on the combined number of students who enter repayment during the applicable award year and the combined number of students who default during the applicable award years at the school under both the old and new control.

Cite: 34 CFR 674.5(d)