

DEPARTMENT OF EDUCATION**34 CFR Part 685**

RIN 1840-AC22

William D. Ford Federal Direct Loan Program

AGENCY: Department of Education.

ACTION: Final regulations.

SUMMARY: The Secretary of Education amends the William D. Ford Federal Direct Loan (Direct Loan) Program regulations. The regulations apply to loans under the Federal Direct Stafford/Ford Loan (Direct Subsidized Loan) Program, the Federal Direct Unsubsidized Stafford/Ford Loan (Direct Unsubsidized Loan) Program, the Federal Direct PLUS Loan (Direct PLUS Loan) Program, and the Federal Direct Consolidation Loan (Direct Consolidation Loan) Program, collectively referred to as the Direct Loan Program. These regulations provide schools with more flexibility in performing origination functions, and clarify the date of loan origination. Further, these regulations set timelines for the submission of promissory notes, disbursement records, and origination records.

EFFECTIVE DATE: These regulations take effect July 1, 1996.

FOR FURTHER INFORMATION CONTACT: Ms. Katrina Ingalls, Program Specialist, Direct Loan Policy Group, Policy Development Division, U.S. Department of Education, Room 3053, ROB-3, 600 Independence Avenue, SW., Washington, DC 20202-5400. Telephone: (202) 708-9406. Individuals who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1-800-877-8339 between 8 a.m. and 8 p.m., Eastern time, Monday through Friday.

SUPPLEMENTARY INFORMATION:**Background**

The Secretary is amending the Direct Loan Program regulations to improve the program based on experience gained during the first year of operation. These amended regulations reflect programmatic changes that the Secretary believes will improve services to student and parent borrowers, increase institutional flexibility, and enhance the Department's administrative and fiscal oversight capabilities.

On September 20, 1995, the Secretary published the proposed amended regulations in a notice of proposed rulemaking (NPRM) for part 685 in the Federal Register (60 FR 48858). The

major issues surrounding the proposed changes were discussed in the NPRM and thus will not be repeated here.

The following section summarizes the two revisions to the proposed rule.

Substantive Revisions to the Proposed Rule*Section 685.215(h)(2) Repayment Plans*

The NPRM proposed to revise the repayment plan regulations to reflect the Secretary's current operational practice regarding repayment plan selection for certain Direct Consolidation Loan borrowers. Under the NPRM, borrowers who consolidate only one FFEL Program loan into the Direct Loan Program would be required to select initially a repayment plan other than the standard repayment plan. The Secretary has determined that this restriction will not be included in the final regulations.

Section 685.301 Origination of a Loan by a Direct Loan Program School

The NPRM proposed that the date of loan origination be the earlier of the date the promissory note is printed or the date the origination record is accepted by the Secretary. The Secretary has revised § 685.301(a)(5) to provide that the date of loan origination is the date the school creates the electronic loan origination record for a borrower. Beginning with the 1996-1997 academic year, enhanced loan origination software will record the date of origination permanently on the borrower's loan file when the borrower's origination record is created by the school. Modifying the Direct Loan school software to record automatically the date the school creates the origination record will ensure that a school is able to document clearly the date that it certified the borrower's eligibility for the loan, the loan amount, and anticipated disbursement dates. The date the electronic origination record is created occurs earlier in loan processing than either printing the promissory note or the origination record being accepted by the Secretary. This change will result in improved service to schools by automatically generating the information necessary to document the origination process and will improve services to borrowers by promoting flexibility in processing loans.

Analysis of Comments and Changes

In response to the Secretary's invitation in the NPRM, ten parties submitted comments on the proposed regulations. An analysis of the comments appears below, beginning with a general discussion of the

comments received concerning the length of the comment period. This is followed by a general discussion of the comments received regarding the Secretary's consideration of establishing foreign school participation requirements for the Direct Loan Program.

A discussion of the major issues that generated comments follows. The major issues are grouped according to subject, with references to the appropriate sections of the regulations. Technical and other minor changes, and suggested changes the Secretary is not legally authorized to make under the applicable statutory authority, generally are not addressed.

General Discussion of Length of Comment Period

Several commenters argued that the comment period was too short, especially considering that the Department published six NPRMs, all with comment periods ending at approximately the same time.

In the six NPRMs referred to above, the Secretary proposed numerous improvements and necessary changes to the Student Financial Assistance Programs. The "Master Calendar" provisions contained in section 482 of the Higher Education Act of 1965 (HEA) require that regulations be published in final form by December 1 prior to the start of the award year for which they will become effective. Because of the importance of implementing these changes and improvements for the award year beginning July 1, 1996, the Secretary established a comment period that would allow publication of these final regulations by December 1, 1995, consistent with the "Master Calendar" timeframe. The Secretary always endeavors to provide as long a comment period as possible.

General Discussion of Foreign School Participation Comments

In the preamble of the NPRM, the Secretary asked for comments and supporting arguments on:

- What, if any, additional standards should be established for foreign schools that participate in the Direct Loan Program;
- Potential financial risks as well as benefits of admitting foreign schools into the Direct Loan Program; and
- Potential losses or benefits to students related to foreign school participation in the Direct Loan Program.

One foreign school responded to the Secretary's invitation for comments. This school expressed enthusiasm about the Direct Loan Program because it

views potential participation as a way to solve some of the problems the school is currently experiencing in receiving loan funds under the FFEL Program. The commenter supported foreign school participation in the Direct Loan Program.

Further, the commenter suggested that the Secretary should not group all foreign schools together for purposes of participation in the Direct Loan Program and recommended that a separate category be established for schools that are located outside of the U.S. but are U.S. accredited. It is the school's opinion that this group would present a lower potential financial risk for the Federal Government since these schools maintain a U.S. Admissions Office and a U.S. dollar bank account. This commenter also pointed out the importance of making sure that foreign schools have trained individuals processing loans for their students.

Another commenter felt that it was premature to consider foreign school participation in the Direct Loan Program and recommended that processing system changes be implemented prior to allowing foreign school participation.

A third commenter recommended that foreign schools be allowed to participate, but not allowed to originate loans. This commenter suggested that foreign schools be required to use an alternative originator. This suggestion was made based on the commenter's opinion that all foreign schools are not uniform in their ability to administer the Title IV programs.

The Secretary understands and appreciates the issues raised by these commenters. As discussed in the NPRM, the Secretary is aware that, due to the nature of the Direct Loan Program, additional fiscal oversight and administrative requirements are warranted for participating foreign schools. The Direct Loan Program is unique among the financial aid programs with respect to its funds disbursement processes and requirements. Because there is no authorized limit to the amount of funds that schools may draw down in the Direct Loan Program, the Department must rigorously oversee the funds disbursement process. To prevent potential program abuse, the Secretary is committed to the careful monitoring of the drawdown of funds to schools and the disbursement to students.

Based on the comments received, the Secretary has determined that the issue of foreign school participation in the Direct Loan Program warrants further consideration. Therefore, no specific provisions related to foreign school

participation are included in these regulations.

Discussion of Major Issues

Section 685.102 Definitions

School Origination Option 1, School Origination Option 2, and Standard Origination

Section 685.102(b)

Comments: Several commenters responded to the proposed revisions of the current definitions of school origination option 1, school origination option 2, and standard origination. These commenters viewed these changes as a positive step that would allow institutions greater flexibility to have the origination process modified based on their unique capabilities and individual needs.

Several other commenters did not support the proposed change. These commenters argued that the Secretary should not amend the "origination requirements."

Discussion: It appeared from the comments that there may be some confusion regarding the proposed change. The Secretary is not changing the origination criteria, nor is the Secretary redesignating the functions performed at a given level of origination. The purpose of this amendment is to allow a school the flexibility to ask the Secretary to perform a function that the school must, under current regulation, perform, at a given origination level. If the Secretary approves the school's request, the Secretary will perform the functions, but the school would not be required to change its origination level.

For example, during the 1996-1997 academic year, an origination option 2 level school is fully qualified to perform all loan origination functions and to draw down loan funds. If a school wanted to ask the Secretary to handle the promissory note functions, but still wanted to be able to draw down funds (for which the school is fully qualified), current regulations would not allow this option. The proposed change would allow the Secretary to establish this type of individual agreement with the school.

The proposed regulatory amendment would not undermine the integrity of the program or the Secretary's ability to provide sound oversight. Furthermore, the change is consistent with the Secretary's current initiative to promote regulatory flexibility and reduce unnecessary burden on institutions. The Secretary is confident that this regulatory change allows schools to customize the origination process in a manner that would be beneficial for

schools, as well as the Direct Loan Program.

Change: For clarity, the word "status" has been changed to "options" in each of the definitions.

Comments: A number of commenters recommended that any revisions to the origination criteria be established through negotiated rulemaking. These commenters noted that the existing origination criteria were developed through extensive negotiated rulemaking.

Discussion: Section 457 of the HEA requires the Secretary to conduct negotiated rulemaking for the Direct Loan Program only to the extent practicable. This section does not require negotiated rulemaking for amendments to existing regulations. Further, the Secretary does not believe that it is practicable to conduct negotiated rulemaking for amendments to these regulations. Negotiated rulemaking is a lengthy process that would have prevented implementation of the revised definitions of school origination option 1, school origination option 2, and standard origination for the 1996/1997 academic year. For these amendments, the Secretary has decided not to use the negotiated rulemaking process to solicit input from the higher education community. In the Secretary's opinion, these changes are a positive step that allow institutions the flexibility to modify the origination process based on their individual needs and capabilities. Because this is an improvement over the existing process, schools should be able to benefit from these regulatory revisions as soon as possible. The majority of the commenters supported the Secretary's proposal to revise these definitions of origination criteria.

Changes: None.

Section 685.208 Repayment Plans, Section 685.210 Choice of Repayment Plans, and Section 685.215 Consolidation

Comments: None of the commenters supported these proposed amendments. One commenter argued that borrowers with one FFEL Program loan should not be precluded from initially consolidating into the Direct Loan Program using the standard repayment plan. The commenter felt that a borrower's repayment options should not be limited by the number of loans the borrower wishes to consolidate. The commenter also asserted that, if the standard repayment plan offered the best terms for that Direct Consolidation Loan borrower, that option should be available to the borrower.

Discussion: The Departmental practice of requiring borrowers who consolidate only one FFEL Program loan into the Direct Loan Program to initially select a repayment plan other than the standard repayment plan had been implemented in response to the concerns of the FFEL community. However, none of the commenters wrote in support of this provision. Further, the only specific comment addressing this proposal was received from a member of the FFEL community, and that commenter urged the Secretary to delete this provision.

Change: Proposed amendments to §§ 685.208, 685.210 and 685.215 have been removed.

Section 685.301 Origination of a Loan by a Direct Loan Program School

Section 685.301(a)(5) Determining Eligibility and Loan Amount

Comments: Several commenters supported the amendment to clarify the date of loan origination. One commenter objected to the Secretary's clarification of the date of loan origination for the Direct Loan Program. This commenter felt that both the Direct Loan and FFEL Programs should establish the same definition for the "date of origination." If this is not possible, the commenter suggested the Secretary create another term for "the date of origination" in the Direct Loan Program to avoid possible confusion among Direct Loan and FFEL Program participants.

Discussion: It is important to establish clearly the date of origination, because a school may only originate a loan while the borrower meets the eligibility requirements. The NPRM proposed that the date of loan origination be the earlier of the date the promissory note is printed or the date the origination record is accepted by the Secretary. Beginning with the 1996-1997 academic year, enhanced loan origination software will record the date of origination permanently on the borrower's loan file when the borrower's origination record is created by the school. Modifying the Direct Loan school software to record automatically the date the school creates the origination record will ensure that the school is able to document clearly the date that it certified a borrower's eligibility for a loan, the loan amount, and anticipated disbursement dates. Further, because the electronic origination record is created earlier in loan processing than either printing the promissory note or the origination record being accepted by the Secretary, this change will result in improved service to both schools and borrowers.

Service to schools is improved because the information necessary to document the origination process is automatically generated in the student's electronic file; service to borrowers is improved by promoting flexibility in processing loans.

The Secretary is making every effort to ensure conformity between the Direct Loan and the FFEL Programs whenever possible. However, there is no definition of "date of origination" in the FFEL Program. Further, the programs operate differently and it is impossible to attain absolute conformity between the programs in all aspects. For example, loan origination in the Direct Loan Program is similar to certification of the loan application in the FFEL Program but because of the inherent operational differences between the program, the two events are not necessarily identical. In the FFEL Program, school officials certify borrower information on a combined application and promissory note. In the Direct Loan Program, the application process is separate from certification of loan information. Therefore, Direct Loan eligibility is certified by means of the electronic origination record and a written statement provided by the school after submitting the origination record. On the origination record, a school certifies a borrower's eligibility, the loan amount, and the anticipated disbursement dates. Due to these operational differences, it is not appropriate to have the same provision in both loan programs. Further, because very few schools participate in both the Direct Loan and FFEL Programs, the Secretary does not believe that this terminology will cause confusion.

The Secretary wants to clarify that the use of the phrase "date of loan origination" in the Direct Loan Program is intended for operational purposes only and does not constitute a commitment on the part of the Federal Government to make a loan. This distinction is important to avoid possible confusion with the use of the term "origination" for Federal budgetary purposes.

Changes: The regulation has been revised to reflect that the date of loan origination is the date a school creates an electronic loan origination record.

Section 685.301(d) Reporting to the Secretary

Comments: Three commenters felt that the requirement for schools to submit the promissory note, disbursement record, and origination record no later than 30 days following the date of disbursement of loan funds was too restrictive. One of these

commenters asked the Secretary to reconsider this timeline because the 30-day deadline would be too burdensome to adhere to in light of other program requirements, such as reconciliation reporting requirements. Another of these commenters suggested that the timeline be extended to 45 days to aid financial aid administrators during their demanding Fall season. This commenter felt that the extra 15 days would make a significant difference in the management of financial aid processes.

Several other commenters strongly endorsed the 30-day reporting requirement. They argued that if schools are required to submit these documents to the Secretary quickly, borrowers will be better served. Additionally, these commenters felt this requirement would result in the reconciliation processing working more smoothly and occurring on a more timely basis—ultimately leading to better fiscal control over federal funds.

One commenter recommended that regulations be added to limit a school's ability to draw down funds until the school had reconciled the funds it had already disbursed. Another commenter recommended that, even though the commenter supported the 30-day reporting requirement, the Secretary should grant schools a brief extension if this requirement presents unanticipated compliance difficulties.

Discussion: The Secretary disagrees with the commenters that assert that this requirement is too restrictive and overly burdensome for the schools. In previous guidance, the Department has advised all Direct Loan schools that they should reconcile and submit all loan origination records, promissory notes, and disbursement records on a monthly basis [see the April 26, 1994, Announcement of Criteria for Loan Origination—1995-1996 Academic Year (59 FR 21804) and Chapter 7 of the *Direct Loan School Guide*]. This requirement is needed to ensure that borrowers receive disbursement disclosure information and loan servicing information shortly after the loan is disbursed. Further, Direct PLUS Loan borrowers enter repayment when the loan is fully disbursed and the Department must receive disbursement information in a timely manner in order to establish repayment terms. Requiring the timely submission of program data by schools to the Direct Loan Servicer will enhance the Department's administrative and fiscal oversight capabilities and will help ensure that up-to-date data are maintained in the National Student Loan Data System.

After a year of experience in administering the Direct Loan Program,

the Secretary is convinced that services to borrowers would be substantially improved by requiring schools to submit the promissory note, disbursement record, and origination record no later than 30 days following the date of disbursement of loan funds. The implementation of this 30-day requirement is in the best interest of federal taxpayers as well as Direct Loan schools. Furthermore, the timely submission of origination records, promissory notes, and initial and subsequent disbursement records is particularly critical at the end of the Federal fiscal year (September 30).

Ultimately, the result of this requirement will be that borrowers will have fewer questions and problems in the initial phase of the loan process. Also, schools will benefit from this change because schools that do not report disbursements in a timely manner appear to have excess cash even when they have properly disbursed funds to borrowers in compliance with the cash management regulations. The Secretary is confident that the 30-day reporting requirement will help the reconciliation process to work more smoothly and on a more timely basis, ultimately leading to better fiscal control over federal funds and improved services to borrowers.

The Secretary understands that, particularly for Direct Loan schools during their first year of participation in the program, the Department may initially need to extend reasonable lenience when enforcing this requirement. These schools may need additional time or assistance until they become familiar with the Direct Loan processes and procedures. Furthermore, the Secretary has already committed to current program participants that the Secretary will assist any schools having difficulty in complying with this requirement. The Secretary is ready to provide technical support to schools and is willing to review a school's on-site operations, if requested, to make suggestions regarding changes that will enable the school to meet this requirement.

Based on the comments received on this issue, it appears that some commenters are confused about when a borrower receives the disclosure of loan information in the Direct Loan Program. Every Direct Loan borrower receives disclosure information on the Direct Loan promissory note prior to disbursement. The disclosure that is mailed from the Direct Loan Servicing Center following any disbursement is in addition to the initial disclosure.

Changes: None.

Executive Order 12866

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

The potential costs associated with the final regulations are those resulting from statutory requirements and those determined by the Secretary as necessary for administering this program effectively and efficiently.

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

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

Summary of Potential Costs and Benefits

The potential costs and benefits of these final regulations are discussed elsewhere in this preamble under the following heading: *Analysis of Comments and Changes.*

Assessment of Educational Impact

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

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

List of Subjects in 34 CFR Part 685

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

(Catalog of Federal Domestic Assistance Numbers: 84.268, William D. Ford Federal Direct Loan Program)

Dated: November 22, 1995.

Richard W. Riley,
Secretary of Education.

The Secretary amends part 685 of title 34 of the Code of Federal Regulations to read as follows:

**PART 685—WILLIAM D. FORD
FEDERAL DIRECT LOAN PROGRAM**

1. The authority citation for Part 685 continues to read as follows:

Authority: 20 U.S.C. 1087a et seq., unless otherwise noted.

2. Section 685.102, paragraph (b) is amended by revising the definition of "School origination option 1," "School origination option 2," and "Standard origination."

§ 685.102 Definitions.

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(b) * * *

School origination option 1: In general, under this option the school performs the following functions: creates a loan origination record, transmits the record to the Servicer, prepares the promissory note, obtains a completed and signed promissory note from a borrower, transmits the promissory note to the Servicer, receives the funds electronically, disburses a loan to a borrower, creates a disbursement record, transmits the disbursement record to the Servicer, and reconciles on a monthly basis. The Servicer initiates the drawdown of funds for schools participating in school origination option 1. The Secretary may modify the functions performed by a particular school.

School origination option 2: In general, under this option the school performs the following functions: creates a loan origination record, transmits the record to the Servicer, prepares the promissory note, obtains a completed and signed promissory note from a borrower, transmits the promissory note to the Servicer, determines funding needs, initiates the drawdown of funds, receives the funds electronically, disburses a loan to a borrower, creates a disbursement record, transmits the disbursement record to the Servicer, and reconciles on a monthly basis. The Secretary may modify the functions performed by a particular school.

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Standard origination: In general, under this option the school performs the following functions: creates a loan origination record, transmits the record to the Servicer, receives funds electronically, disburses funds, creates a disbursement record, transmits the disbursement record to the Servicer, and reconciles on a monthly basis. The Servicer prepares the promissory note, obtains a completed and signed promissory note from a borrower, and initiates the drawdown of funds for schools participating in standard

origination. The Secretary may modify the functions performed by a particular school.

(Authority: 20 U.S.C. 1087a *et seq.*)

3. Section 685.201 is amended by revising paragraph (a)(2) introductory text, and paragraph (b) to read as follows:

§ 685.201 Obtaining a loan.

(a) * * *

(2) If the student is eligible for a Direct Subsidized Loan or a Direct Unsubsidized Loan, the Secretary or the school in which the student is enrolled shall perform specific functions. Unless a school's agreement with the Secretary specifies otherwise, the school shall perform the following functions:

* * * * *

(b) *Application for a Direct PLUS Loan.* To obtain a Direct PLUS Loan, the parent shall complete the application and promissory note and submit it to the school at which the student is enrolled. The school shall complete its portion of the application and promissory note and submit it to the Servicer, which makes a determination

as to whether the parent has an adverse credit history. Unless a school's agreement with the Secretary specifies otherwise, the school shall perform the following functions: A school participating under school origination option 2 shall draw down funds and disburse the funds. For a school participating under school origination option 1 or standard origination, the Servicer initiates the drawdown of funds, and the school disburses the funds.

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(Authority: 20 U.S.C. 1087a *et seq.*, 1091a)

4. Section 685.301 is amended by redesignating paragraphs (a)(5) and (a)(6) as paragraphs (a)(6) and (a)(7), respectively, adding a new paragraph (a)(5) and by adding a new paragraph (d) to read as follows:

§ 685.301 Origination of a loan by a Direct Loan Program school.

(a) * * *

(5) The date of loan origination is the date a school creates the electronic loan origination record.

* * * * *

(d) *Reporting to the Secretary.* (1) A school that originates a loan must submit the promissory note, loan origination record, and initial and subsequent disbursement records to the Secretary no later than 30 days following the date of disbursement. A school must submit the loan origination record and disbursement record to the Secretary no later than 30 days following the date of disbursement for each subsequent disbursement.

(2) A school that participates under standard origination must submit the initial and subsequent disbursement record to the Secretary no later than 30 days following the date of disbursement. A school must submit the disbursement record to the Secretary no later than 30 days following the date of disbursement for each subsequent disbursement.

(Authority: 20 U.S.C. 1087a *et seq.*)

(Approved by the Office of Management and Budget under Control Number 1840-0672)

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