

*Repayment terms vary substantially among Perkins Loans, National Direct Student Loans, and National Defense Student Loans. Schools may choose to obtain software from third-party vendors that have automated many of the following requirements and calculations.*

### GRACE PERIODS

A “grace period” is the period of time before the borrower must begin or resume repaying a loan. An “initial grace period” is one that immediately follows a period of enrollment and immediately precedes the date repayment is required to begin for the first time.

#### *Initial grace periods*

A borrower who has been attending at least half time is entitled to an initial grace period of nine consecutive months after dropping below half-time enrollment.

For a student attending at least half time, the initial grace period does not end until he or she ceases to be enrolled at least half time for a continuous period of nine months. A borrower who returns to school on at least a half-time basis prior to completion of the initial grace period is entitled to a full initial grace period (nine consecutive months) from the date that he or she drops below half-time enrollment again.

If a borrower requests a deferment to begin during the initial grace period, the borrower must waive (in writing) his or her rights to the initial grace period. The request for a deferment alone is not sufficient documentation for a school to waive the initial grace period; the borrower must also acknowledge in writing that he or she wants the waiver. (Deferments are discussed in chapter 5 of this volume.)

For a borrower who is a member of the Armed Forces Reserve, the initial grace period does not include any period up to three years during which the borrower is called or ordered to active duty for more than 30 days, including the period necessary for the borrower to resume enrollment at the next available enrollment period. The period necessary for the borrower to resume enrollment at the next available enrollment period may not exceed 12 months. The borrower must notify you of the beginning and end dates of her service, and the date she resumes enrollment. Borrowers who enroll in a different program when they return from

#### **Initial grace period definition cite**

34 CFR 674.2

#### **Length of initial grace period cite**

34 CFR 674.31(b)(2)(i)(B)

#### **Initial grace period examples**

Gordon takes out a Perkins Loan in the fall quarter at Sims School of Botany, drops out of school for the winter quarter, and resumes at least half-time study for the spring quarter. Gordon is entitled to a full initial grace period once he again leaves school or drops below half-time status.

Heather takes out several Perkins Loans to attend Flocker University. She attends for four consecutive years, graduates, and begins her initial grace period. During her initial grace period, Heather joins the Peace Corps and requests economic hardship deferment. Flocker University cannot waive Heather’s initial grace period and begin the economic hardship deferment. Heather must acknowledge in writing that she is waiving her initial grace period.

#### **Grace period delayed during active duty cite**

34 CFR 674.31(b)(2)(i)(C)

**Initial grace periods for NDSLs and Defense Loans**

Repayment of an NDSL made before October 1, 1980, begins **nine months** after the date that the borrower drops below half-time enrollment. Repayment of an NDSL made on or after October 1, 1980 begins **six months** after the date that the borrower drops below at least half-time enrollment.

<b>Applicable Grace Periods</b>	<b>Perkins</b>	<b>NDSL on or after 10-1-80</b>	<b>NDSL before 10-1-80</b>
<i>Initial Grace Period</i>	9 months	6 months	9 months
<i>Post-deferment Period</i>	6 months	6 months	6 months

active duty are entitled to the same grace period benefits. A borrower who is in a grace period when called or ordered to active duty is entitled to a new grace period upon conclusion of the excluded period.

**Post-deferment grace periods**

A “post-deferment grace period” is the period of six consecutive months that immediately follows the end of a period of deferment and precedes the date on which the borrower must resume repayment on the loan. Neither the deferment nor the grace period is counted as part of the 10-year repayment period.

Except for hardship deferments on loans made before July 1, 1993 (see chapter 5 of this volume for more information), all deferments for all loans made under the Federal Perkins Loan Program have post-deferment grace periods of six consecutive months.

**Initial grace period for less-than-half-time attendance**

A borrower who is attending less than half time and who has no outstanding Perkins Loan or National Direct Student Loan (NDSL) must begin repaying a new loan nine months from the date the loan is made or nine months from the date the borrower ceases to be enrolled as a regular student on at least a half-time basis<sup>1</sup>, whichever is earlier.

A borrower who is attending less than half time and who has an outstanding Perkins Loan or NDSL must begin repayment on an additional loan when the next scheduled installment of the outstanding loan is due; there is no formal grace period or in-school deferment on the new loan.

**Calculating the grace period**

A grace period is always day-specific—an initial grace period begins the day after the day the borrower drops below half-time enrollment. Likewise, a post-deferment grace period begins on the day immediately following the day on which an authorized period of deferment ends.

If a borrower has received loans with different grace periods (and different deferment provisions), the borrower must repay each loan according to the terms of its promissory note; the borrower must pay the minimum monthly payment amount that applies to each loan that is not in a grace or deferment period.

**Post-deferment grace period definition cite**

34 CFR 674.2

**Less-than-half-time grace period cite**

34 CFR 674.32

**Less-than-half-time student/no loan grace period example**

Paula starts school full time in September 2003. She does not have an outstanding Perkins Loan or NDSL. In January 2004, Paula drops to one-quarter time. In March 2004, she receives a Perkins Loan. Since Paula dropped below half-time enrollment **before** the Perkins Loan was made, Paula must begin repayment nine months after the date she dropped below half-time enrollment---October 2004.

**Less-than-half-time student/outstanding loan grace period example**

Jason has been making monthly payments on Perkins Loan #1. He takes out Perkins Loan #2 in September. His next payment on Loan #1 is due October 15. Jason will begin repaying Loan #2 at the same time.

**Remember that the repayment status of the outstanding loan determines the repayment status of the second loan.**

1. This nine-month period includes the date the loan was made.

### Grace Periods for Students Who Don't Return From Leaves of Absence

34 CFR 668.22 (b)(1)  
34 CFR 668.22 (c)(1)(v)  
34 CFR 668.22 (d)(1)(ix)

Students granted approved leaves of absence retain their in-school status for FSA loans. However, if a student does not return from an approved leave of absence, the student's grace period begins the date the student began the leave of absence. (If the school is required to take attendance, the grace period begins on the last date of academic attendance.)

For a student who does not return from an approved leave of absence, this withdrawal date might result in the exhaustion of some or all of the student's grace period.

Leaves of absence no longer qualify as approved leaves of absence for FSA purposes unless the school explains the effects that the student's failure to return from an approved leave of absence might have on the student's loan repayment terms, including the exhaustion of some or all of the student's grace period.

## PREPAYMENT

If the borrower repays more than the amount due for any repayment period after the initial grace period has ended, the school must use the excess to prepay principal, unless the borrower designates the excess as an advance payment on the next regular installment. If the borrower designates the excess as an advance payment on the next installment and that advance payment exceeds the amount of the next regularly scheduled installment, the school must use the excess to prepay principal.

The borrower may prepay all or part of the loan at any time without penalty. Amounts repaid during the academic year the loan was made and before the initial grace period has ended are not considered prepayments but must be used to reduce the original loan amount.

## INTEREST ACCRUAL

Interest on a Perkins Loan must be computed at the rate of 5% per annum simple interest on the unpaid principal balance. Although interest accrues on a Perkins Loan, *your school may not capitalize it*. This means that your school may not add unpaid interest to the principal balance to increase the principal balance of the Perkins Loan. Instead, your school must track principal and interest as separate figures, adding accrued interest to the interest balance, *not* the principal balance.

### Prepayment cite

34 CFR 674.31(b)(4)

### Payment made during initial grace period example

Shannon applies her yearly birthday check of \$400 to her \$1,000 Perkins Loan before the initial grace period ends. The principal advanced to Shannon becomes \$600. This is not considered a prepayment because payment was made before the end of the initial grace period.

### Simple interest accrual example

Fred has been granted a hardship forbearance for a year. At the beginning of his forbearance period, Fred's loan balance is \$1000:

Principal: **\$1000**  
Interest: **\$0**

Interest accrues throughout the forbearance period at a simple rate of 5% per annum. At the end of the year-long forbearance period, Fred's loan balance is \$1050:

Principal: **\$1000**  
Interest: **\$50**

When Fred makes his first payment after the end of the forbearance, his payment is applied to interest first, then principal. Fred makes a payment of \$25, reducing his balance to \$1025:

Principal: **\$1000**  
Interest: **\$25**

Generally, interest is computed from the date a payment is received rather than from the due date. However, there are exceptions. Interest charges may be computed to the nearest first-of-the-month, or they may be computed in accordance with the borrower's established schedule of payments of principal and interest if the borrower is making payments on a regular basis according to that schedule. For example, if a grace period expires in the middle of a month, interest may be computed to the beginning of the next month. Also, if a past-due payment is received before the next regularly scheduled payment, the interest may be computed according to the established payment schedule—no adjustments are necessary.

National Defense Student Loans (Defense Loans), NDSLs, and older Perkins Loans have different interest rates. The interest rate is stated in the borrower's promissory note. The annual interest rate for loans made before July 1, 1981 was 3 percent; between July 1, 1981 and September 30, 1981 was 4 percent; on or after October 1, 1981 is 5 percent.

## ESTABLISHING A REPAYMENT PLAN

A borrower must repay his or her loan, plus interest, in 10 years. This repayment period never includes authorized periods of deferment, forbearance, or cancellation.

The repayment plan must be established and disclosed to the student before the student ceases to be enrolled at least half time. Please see chapter 7 of this volume for a detailed discussion of repayment information disclosure.

If a borrower wants to repay the loan in graduated installments, he or she must request permission to do so from the school; if the school agrees to this type of repayment, a graduated installment schedule is prepared and submitted to the Department for approval. If the Department approves the school's request, the borrower may use the graduated method of repayment.

If a student receives loans from more than one school, the repayment of each loan is made to (or default is attributed to) the school where the student received the loan.

### *Calculating the payment amount*

Schools may require the borrower to make payments on a monthly, bimonthly, or quarterly basis. Each of the borrower's payments must sufficiently cover the interest accruing between payments to ensure that the loan is repaid in 10 years. Schools calculate the correct payment amount by multiplying the principal by the appropriate constant multiplier (see table). (Schools using the minimum monthly payment plan option, introduced in the next section, may require the borrower to pay a minimum monthly amount of \$40 instead.)

#### Repayment plan cite

34 CFR 674.33(a)

#### Payment amount cite

34 CFR 674.33(a)

#### Calculating payment amount example

Bernadine received a \$2,500 Perkins Loan to attend Jordan College, which requires quarterly payments. To calculate Bernadine's quarterly payment, Jordan College multiplies the original principal by the constant multiplier for a quarterly payment frequency:

$$\$2,500 \times .0319214 = \$79.80$$

## 10-Year Repayment Table of Constant Multipliers

<i>Annual Rate</i>	<i>Payment Frequency</i>	<i>Payments per Year</i>	<i>Total Payments</i>	<i>Constant Multiplier</i>
5%	<i>Monthly</i>	12	120	.0106065
5%	<i>Bimonthly</i>	6	60	.0212470
5%	<i>Quarterly</i>	4	40	.0319214

$$\text{Principal} \times \text{Constant Multiplier} = \text{Payment Amount}$$

If the installment for all loans a school made to a borrower is not a multiple of \$5, the school may round the installment payments to the next highest dollar amount that is a multiple of \$5.

If the last scheduled payment is \$25 or less, the school may combine it with the next-to-last payment.

### MINIMUM MONTHLY REPAYMENT AMOUNTS

Schools may choose to include a minimum monthly repayment requirement in the Perkins Loan promissory note.

The minimum monthly repayment amount is \$40, unless the borrower on the date the new loan is made has an outstanding balance on a Perkins Loan, NDSL, or Defense Loan made before October 1, 1992 that included a \$30 minimum monthly repayment provision. (See sidebar.)

To determine the minimum repayment for bimonthly and quarterly payment schedules, schools should multiply \$40 by 2 (months) and 3 (months) respectively.

#### *Conditions for minimum monthly repayment*

A school may require a borrower to pay a minimum monthly payment amount of \$40 on a Perkins Loan if:

- the promissory note includes a provision specifying a minimum monthly repayment of \$40 and the monthly repayment of principal and interest for a 10-year repayment period (as calculated using a constant multiplier) would be less than \$40; or

#### **Minimum monthly repayment cite**

34 CFR 674.33(b)

#### **Minimum monthly repayment amount for older loans**

The minimum monthly repayment amount is **\$30** for NDSLs, Perkins Loans made before October 1, 1992, and Perkins Loans made after October 1, 1992 to borrowers who have an outstanding balance on a Perkins Loan, NDSL, or Defense Loan made before October 1, 1992 that included a \$30 minimum monthly repayment provision. The minimum monthly repayment amount is **\$15** for Defense Loans. If a borrower has both Defense and NDSL or Perkins Loan from one or more schools and the total monthly repayment is less than \$30 and the monthly repayment on a Defense Loan is less than \$15, the amount applied to the Defense Loan may not exceed \$15.

**Minimum monthly payment for multiple loans at same school example**

Harv has Perkins Loans of \$1,500 and \$1,000 (for a total debt of \$2,500) and has a promissory note that includes the minimum monthly payment provision. Using the constant multiplier table, the total monthly payment on the two loans would be less than \$40:

<b>Monthly payment on loan #1</b>	
\$1,500 X .0106065 =	\$15.91
<b>+ Monthly payment on loan #2</b>	
\$1,000 X .0106065 =	\$10.61
<b>= Total payment per month</b>	\$26.52

Because the monthly payment on the two loans is less than \$40, Moore University may decide to exercise the minimum \$40 payment option. If the school does so, it calculates the monthly payment for each loan by dividing the original principal of the loan by the total original principal of all loans:

<b>Monthly payment on loan #1</b>	
\$1,500 ÷ \$2,500 =	.600000
	X \$40
	\$24

<b>Monthly payment on loan #2</b>	
\$1,000 ÷ \$2,500 =	.400000
	X \$40
	\$16

<b>Monthly payment on loan #1</b>	\$24
<b>+ Monthly payment on loan #2</b>	\$16
<b>= Total payment per month</b>	\$40

**Two schools/minimum monthly payment amount example**

Jennifer has Perkins Loans from Shady Acres College and Sunnysdale University. Shady Acres does not exercise the minimum monthly payment option and receives \$25 a month (the amount due under its established 10-year repayment plan). Sunnysdale exercises the \$40 option and receives \$15, the difference between \$40 and the amount of principal and interest paid to Shady Acres.

- the borrower has received Perkins Loans with different interest rates at the same school and the total monthly payment would otherwise be less than \$40 (provided any of the promissory notes includes the minimum monthly repayment provision).

Under no circumstances may a school require a minimum monthly repayment of more than \$40.

**Multiple loans at same school**

If a borrower has multiple Perkins Loans from the same school, any of which include the minimum monthly payment provision, the school may require the borrower to make a minimum monthly payment if the borrower's total monthly payment on all the loans totals less than \$40.00<sup>2</sup>. If the school exercises this option, the school must divide each monthly payment among all the loans proportionate to the amount of principal advanced under each loan. If the borrower's total monthly payment equals or exceeds \$40.00 for all of the loans made at that school, the school may not exercise the minimum monthly payment on any loan.

The school determines the minimum monthly repayment in this manner even if the Perkins Loans have different interest rates.

If the borrower has received Perkins Loans with different grace periods and deferments, the school must treat each note separately. The school still divides the minimum monthly payment proportionately among the loans. However, the borrower must pay each loan's portion when it is due.

**Loans from multiple schools**

A borrower may have received Perkins Loans from more than one school. If the borrower wants your school to coordinate minimum monthly payments with another school, she must request such coordination.

If the total of the monthly payments is at least equal to \$40, none of the lending schools may exercise the minimum monthly repayment requirement.

If the total monthly repayment is less than \$40, but only one school exercises the minimum monthly payment option, that school receives the difference between \$40 and the repayment owed to the second school.

If the total monthly repayment is less than \$40 and each school exercises the minimum repayment option, the \$40 minimum repayment is divided among the schools in proportion to the total amount of principal each has advanced.

2. A student's monthly payment amount may need to be higher than \$40 (or \$30), of course, so that his or her debt is repaid by the end of 10 years.

If the borrower requests that your school coordinate minimum monthly payment amounts with another school, you should ask the borrower for:

- the names of all other schools to which the borrower owes funds under the Federal Perkins Loan Program;
- the approximate amount borrowed from, and the current indebtedness to, each school; and
- any information that would help identify the loans—for example, the loan number and the dates of loan advances.

Using this information, the schools should contact each other and negotiate the amount each should receive from the borrower.

### **Hardship payment reduction**

A school may reduce a borrower’s scheduled payments for up to one year at a time if the borrower is scheduled to pay the \$40 minimum monthly payment and the school determines that the borrower is unable to make the scheduled payments due to hardship, such as prolonged illness or unemployment.

## **PAYMENT PROCESSING**

Any payment a school receives must be applied in the following order:

1. collection costs,
2. late charges (or penalty charges),
3. accrued interest, and
4. principal.

Past-due payments should be applied in the same order as other payments, except that past-due payments must be applied to the “oldest” past-due dollars first.

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### **Payment processing cite**

34 CFR 674.33(d)

## **INCENTIVE REPAYMENT PROGRAM**

To encourage repayment, a school may:

- reduce a loan’s interest rate by up to 1% if the borrower makes 48 consecutive monthly payments;
- discount by up to 5% the balance a borrower owes on a loan if he or she pays the loan in full before the end of the repayment period; or
- with the Secretary’s approval, establish any other repayment incentive options that reduce default and replenish student loan funds.

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### **Incentive repayment program cite**

34 CFR 674.33(f)

## Perkins Loan Quarterly Billing Example (with four standard repayment dates)

<b>Borrower's Termination Date</b>	<b>Initial 9-Month Grace Period Ends</b>	<b>Installment Due</b>
January 1	September 30	January 1
February 1	October 31	January 1
March 1	November 30	January 1
April 1	December 31	April 1
May 1	January 31	April 1
June 1	February 28	April 1
July 1	March 31	July 1
August 1	April 30	July 1
September 1	May 31	July 1
October 1	June 30	October 1
November 1	July 31	October 1
December 1	August 31	October 1

A school may not use federal funds or school funds from the Perkins Loan revolving fund to absorb the costs associated with repayment incentives. On at least a quarterly basis, schools must reimburse the Perkins Loan Fund for income lost as a result of the discounts offered through the Incentive Repayment Program.

### ESTABLISHING REPAYMENT DATES

Depending on the repayment schedule (monthly, bimonthly, or quarterly), the borrower's first payment is due one, two, or three months from the date the grace period expires. Repayment schedules must be adjusted (preferably on the first installment) so that the loan will be repaid within the normal 10-year period or as prescribed in the terms of the promissory note.

For convenience, a school may establish standard repayment dates for borrowers who are on quarterly repayment schedules. The first repayment date may be the first day of the calendar quarter after the grace period has expired. Four standard repayment dates would be used: January 1, April 1, July 1, and October 1. (See the chart above.)

Another type of repayment schedule is a "rolling" quarterly repayment schedule in which each borrower's first payment is due exactly three months after the date his or her grace period expires. For example, if a borrower's first grace period expires on May 17, the first installment payment is due August 18. Another borrower's grace period expires May 18, so the first installment payment on that loan is due August 19.



## Low-Income Individual Maximum 2002 Income Levels for 2003-2004 Award Year

(derived from Income Protection Allowances published in the May 31, 2002 *Federal Register*)

Number of Family Members (including student)	1	2	3	4	5	6
Maximum 2001 Income Level	\$9,144	\$16,513	\$20,563	\$25,400	\$29,975	\$35,063

**NOTE:** For families of more than 6, add \$4,038 for each additional family member.

For collection and bookkeeping purposes, a fixed repayment date is preferred. Otherwise, if the borrower is entitled to a deferment, the school may have problems computing payments due. (See chapter 5 of this volume.) Once the payment date is established, the borrower will owe principal and interest for any portion of a scheduled installment period not covered by a deferment. However, if the borrower is in deferment on a due date, any amounts owed are carried over and paid on the first due date on which the borrower is out of deferment.

### EXTENDING THE REPAYMENT PERIOD FOR HARDSHIP AND LOW-INCOME INDIVIDUALS

A school may extend a repayment period if the borrower is experiencing a period of prolonged illness or unemployment or if the borrower is a “low-income individual.” A low-income individual is one whose total income for the preceding calendar year does not exceed the maximum income level for his/her family size (see chart). Interest continues to accrue during an extension of a repayment period for any of these reasons.

For NDSLs made on or after October 1, 1980 and for all Perkins Loans, a school may extend the borrower’s repayment period up to 10 additional years if, during the repayment period, the school determines that the borrower qualifies as a low-income individual. The school must review the borrower’s status annually to determine whether he or she still qualifies. Once a borrower no longer qualifies, his or her repayment schedule must be amended so that the number of months in it does not exceed the number of months remaining on the original repayment schedule (not counting the extension period).

There are two other ways that a school may adjust the repayment schedule for a borrower who qualifies as a low-income individual:

- The school may require the borrower to pay a reduced amount for a limited time and then later increase the payment amount so that the borrower catches up on payments. For example, a school reduces the payment amount to \$10 per month for six months and then increases

#### Repayment period extension cite

34 CFR 674.33(c)

#### Calculation of maximum incomes for low-income individuals

34 CFR 674.33(c)(2)

it to \$50 per month until the borrower catches up. The repayment period does not have to be extended; or

- The school may allow the borrower to pay \$10 per month for a year and then resume normal payments. This type of adjustment extends the repayment period.

## DISCHARGE DUE TO DEATH OR TOTAL AND PERMANENT DISABILITY

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### Death and disability discharge cite

34 CFR 674.61

You must discharge the remaining balance of any Perkins Loan, NDSL, or Defense Loan if the borrower dies or becomes totally and permanently disabled. Your school does not receive reimbursement for discharges due to death or disability.

The Department does not approve or supply cancellation forms.

### *Death*

You must base your determination of death of the borrower on an original or certified copy of the death certificate. Previously, you could make a discharge due to death on the basis of a death certificate or other certification recognized by state law.

Under exceptional circumstances and on a case-by-case basis, the chief financial officer of the institution may approve a discharge based upon other reliable documentation supporting the discharge request.

### *Total and permanent disability*

Total and permanent disability is the inability to work and earn money because of an injury or illness that is expected to continue indefinitely or to result in death. The definition of permanent and total disability no longer requires that the borrower be unable to attend school.

The borrower must submit a physician's certification of total and permanent disability. The physician must certify that the borrower is 100% disabled according to the Perkins Loan Program definition of disability.

The following procedures were effective until July 1, 2002:

If you determine, based on the physician's certification, that the borrower is totally and permanently disabled, you must discharge the loan. Your school may not subsequently require the borrower to repay the loan, even if the borrower's medical condition improves to the point that he or she is no longer disabled, unless you can prove that the claim of disability was fraudulent or the borrower receives another Title IV loan within three years of the date he or she became totally and permanently disabled.

The following procedures became effective on July 1, 2002:

If your school determines, based on certification from the borrower's physician, that the borrower is totally and permanently disabled, your school must assign the account to the Department. You must notify the borrower that you have assigned the account to the Department for determination of eligibility for a total and permanent disability discharge.

If the Department makes an initial determination that the borrower is eligible for discharge, the Department will place the loan in a conditional discharge status for up to three years after the date the borrower became totally and permanently disabled as certified by the borrower's physician. A loan placed in conditional discharge status is not considered past due or in default unless the loan was past due or in default at the time the conditional discharge was granted.

If your school receives payments from a borrower on a loan that is in conditional discharge status, you must forward these payments to the Department and notify the borrower that there is no need to make payments on the loan while it is in conditional discharge status. If the Department grants final discharge to the borrower, your school must refund any payments the borrower made after the certified disability date and before the account was assigned to the Department. The Department will refund any payments received after the assignment.

For additional information on assigning loans for discharge contact:

**Disability Discharge Loan  
Servicing Center**

Phone: 1-888-869-4169

TDD: 1-888-636-6401

e-mail: [disability\\_discharge@afsa.com](mailto:disability_discharge@afsa.com).

## CLOSED SCHOOL DISCHARGE

Your school must assign to Federal Student Aid (FSA) Collections all its outstanding Perkins and NDSL loans if it is closing (see Chapter 8 for assignment procedure).

FSA Collections may discharge a Perkins Loan or NDSL made on or after January 1, 1986 if the borrower is unable to complete his or her program of study due to the closure of the school. FSA Collections must reimburse borrowers for payments made voluntarily or by forced collection.

A borrower whose loan was in default and then discharged under this provision is not considered to have been in default and reestablishes Federal Student Aid (FSA) eligibility, provided he or she meets all other eligibility criteria.

FSA Collections reports the discharge to the credit bureaus to which the previous loan status was reported.

You can find a searchable database of closed schools on-line at <http://www.ed.gov/offices/OSFAP/Students/closedschool/> (click on "Closed School Search Page").

### Closed school discharge cite

34 CFR 674.33(g)

## **Bankruptcy laws**

11 U.S.C. 1307, 1325, and 1328(b) are laws applicable to bankruptcy cases in general, not just to Perkins Loan bankruptcy cases. 11 U.S.C. 1307 concerns the dismissal of a Chapter 13 case or the conversion of a case filed under Chapter 13 to a Chapter 7 proceeding. 11 U.S.C. 1325 concerns the confirmation by the court of a borrower's proposed repayment plan. 11 U.S.C. 1328(b) allows a debtor who fails to complete the payments required under the plan to obtain a discharge if conditions are met. A school should consult an attorney for the best advice in bankruptcy cases.

## **BANKRUPTCY DISCHARGE**

The basic actions a school must take when a borrower files for bankruptcy protection are covered here, in Dear Colleague Letter GEN-95-40, dated September 1995, and in 34 CFR 674.49. For the best advice on how to proceed when a borrower files for bankruptcy protection, a school should consult its attorney. The school should ensure that the attorney is aware of the due diligence provisions that apply to school actions.

If a school receives notice that a borrower has filed for bankruptcy protection, it must immediately stop collection efforts (outside the bankruptcy proceeding itself). If the borrower has filed under Chapter 12 or 13 of the Bankruptcy Code, the school must also suspend collection efforts against any endorser.

The school must file a proof of claim in the bankruptcy proceeding unless, in the case of a proceeding under Chapter 7 of the Bankruptcy Code, the notice of meeting of creditors states the borrower has no assets.

Effective for bankruptcies filed on or after October 8, 1998, a borrower who receives a general discharge in bankruptcy does not by that order obtain a discharge of a loan that has been in repayment for seven years or more at the time of the bankruptcy filing. For these bankruptcies, a student loan is discharged by a general discharge order only if the borrower also obtains a court ruling that repayment of the loan would impose an undue hardship on the borrower and his or her dependents.

### ***Responding to complaint for determination of dischargeability***

Customarily, a borrower obtains a judicial ruling of undue hardship by filing an adversary proceeding—a lawsuit within the bankruptcy proceeding—in the bankruptcy court seeking to prove undue hardship. If a borrower files an adversary proceeding to prove undue hardship under 11 U.S.C. 523(a)(8), the school must decide, on the basis of reasonably available information, whether repayment under the current repayment schedule or under any adjusted schedule would impose undue hardship on the borrower and his or her dependents.

If the school concludes that repayment would not impose an undue hardship, the school must then decide whether the expected costs of opposing the discharge would exceed one-third of the total amount owed on the loan (principal, interest, late charges, and collection costs). If the expected costs do not exceed one-third of the total amount owed on the loan, the school must oppose the discharge and, if the borrower is in default, seek a judgment for the amount owed. If necessary, the school may compromise a portion of that amount to obtain a judgment.

If the school opposes a request for determination of dischargeability on the ground of undue hardship, a school may also file a complaint with the court to obtain a determination that the loan is not dischargeable and to obtain a judgment on the loan.

Schools that are State instrumentalities may, as an alternative, oppose an undue hardship claim by asserting their immunity from suit in bankruptcy. As with any other action in defending student loans in bankruptcy, the school should consult with counsel, and should ensure that counsel is fully informed about recent changes in Department regulations to support this position.

### ***Procedures for responding to proposed Chapter 13 repayment plan***

Under Chapter 13, the borrower may generally obtain an adjustment in repayment terms of all of his/her debts. The borrower proposes a repayment plan that addresses whether and how each debt or class of debts will be paid. If the court approves the plan, creditors are bound to the terms of that plan for duration of the plan, typically three to five years. If the borrower's repayment plan proposes full repayment of the Perkins Loan, including all principal, interest, late charges, and collection costs on the loan, no response from the school is required. The school is also not required to respond to a proposed repayment plan that does not include any provision in regard to the Perkins Loan obligation or to general unsecured claims.

If the borrower proposes to repay less than the total amount owed and that the remainder be discharged, the school must determine, from its own records and court documents, the amount of the loan dischargeable under the plan. The school does this by subtracting the total proposed payments from the total amount owed. The school must also determine from its own records and court documents whether the borrower's proposed repayment plan meets the requirements of 11 U.S.C. 1325. Two of those requirements are particularly relevant:

- First, the amount to be paid under the plan must at least equal the amount the school would receive if the debtor had filed under Chapter 7 rather than under Chapter 13.
- Second, to pay creditors under the plan, the debtor must use all income not needed to support himself or herself and his or her dependents.

If the borrower's proposed repayment plan does not meet the requirements of 11 U.S.C. 1325, the school must object to the confirmation by the court of the proposed plan, unless the cost of this action will exceed one-third of the dischargeable loan debt; if the cost will exceed one-third of the dischargeable debt, the school is not required to take this action.

Also, when a borrower proposes to repay less than the total amount owed, the school must determine whether grounds exist

under 11 U.S.C. 1307 for the school to move to have the Chapter 13 case either dismissed or converted to a Chapter 7 proceeding. Such grounds include a borrower's failure to (1) begin payments under the plan within the required time (usually 30 days from the date the plan is filed), (2) file a proposed plan in a timely manner, or (3) pay required court fees and charges. If the school determines that such grounds do exist, the school must move to dismiss or convert the Chapter 13 case to a Chapter 7 proceeding, unless the cost of this action will exceed one-third of the dischargeable loan debt.

After a borrower's proposed repayment plan is confirmed by the court, the school must monitor the borrower's compliance with the repayment plan. If the school determines from its own records or court documents that the borrower either has not made the payments required under the plan or has filed for a hardship discharge under 11 U.S.C. 1328(b), the school must determine whether grounds exist under 11 U.S.C. 1307 to dismiss the case filed under Chapter 13 or to convert the Chapter 13 case to a Chapter 7 proceeding or whether the borrower is entitled to a hardship discharge. If grounds do exist under 11 U.S.C. 1307 to dismiss or convert a Chapter 13 case, the school must move to convert or dismiss the case. If a borrower has not demonstrated entitlement to a hardship discharge under 11 U.S.C. 1328(b), the school must oppose the hardship discharge request, unless the costs of these actions, when added to those already incurred, would exceed one-third of the dischargeable debt.

### ***Resuming/terminating billing and collection***

A school must resume billing and collection procedures after the borrower has received a discharge under 11 U.S.C. 727, 11 U.S.C. 1141, 11 U.S.C. 1228, 11 U.S.C. 1328(a), or U.S.C. 1328(b) unless the court has found that repayment would impose an undue hardship. If the court has found that repayment would impose an undue hardship, the school must terminate all collection action and write off the loan. If a school receives a repayment from a borrower after a loan has been discharged, it must deposit that payment in its Perkins Loan Fund.

### ***Bankruptcies filed before October 8, 1998***

For bankruptcies filed before October 8, 1998, loans in repayment more than seven years by the date of the bankruptcy filing may be discharged by a general discharge order. The school may therefore not resume collection after the borrower has received a discharge if the loan entered repayment more than seven years before the filing of the petition and either of the following conditions apply: (1) the discharge was obtained in a chapter 13 proceeding in which the plan provided for the debt specifically or for unsecured debts in general; or (2) the discharge was obtained in any other bankruptcy proceeding, and the debt was not excepted from discharge by a provision of the Code other than 11 USC 523(a)(8).

If these conditions are met, the school must terminate all collection action and write off the loan.

If the conditions above are met and the borrower additionally files an adversary proceeding for discharge of a loan on the ground of undue hardship under 11 U.S.C. 523(a)(8), the school still may not oppose a determination of dischargeability.

### ***Bankruptcy and student eligibility***

As stated earlier, a borrower is no longer required to establish eligibility for a new student loan by agreeing to repay a loan discharged in bankruptcy. Section 525(c) of the Bankruptcy Code provides that a student may not be denied student financial assistance solely on the basis of a bankruptcy filing or failure to pay a debt dischargeable in bankruptcy. If a student has filed for or received a discharge in bankruptcy, has had a student loan discharged in bankruptcy, or has not paid a student loan that has been determined by a court of law to be dischargeable in bankruptcy, the bankruptcy may be considered as evidence of an adverse credit history but cannot be the basis for denial of a future loan from the Federal Perkins Loan Program or other student loan programs. However, schools may continue to consider the student's post-bankruptcy credit history in determining willingness to repay the loan.