

DEPARTMENT OF EDUCATION

34 CFR Part 685

RIN 1840-AC68

William D. Ford Federal Direct Loan Program

AGENCY: Department of Education.

ACTION: Final regulations.

SUMMARY: The Secretary amends the regulations governing the William D. Ford Federal Direct Loan (Direct Loan) Program. These amendments are a result of recently enacted changes to the Higher Education Act of 1965, as amended by the Higher Education Amendments of 1998. These final regulations remove references to the phase-in of the Direct Loan Program, update the loan interest rate formulas, and reflect the Secretary's authority to charge reduced loan fees on Direct Subsidized and Direct Unsubsidized Loans.

DATES: These regulations are effective August 24, 1999.

FOR FURTHER INFORMATION CONTACT: Ms. Nicki Meoli, U.S. Department of Education, 400 Maryland Avenue, SW., ROB-3, Room 3045, Washington, DC 20202-5346. Telephone: (202) 708-8242. If you use a telecommunications device for the deaf (TDD), you may call the Federal Information Relay Service (FIRS) at 1-800-877-8339.

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SUPPLEMENTARY INFORMATION: These regulations address changes made to the Higher Education Amendments of 1998 (1998 Amendments) (Pub. L. 105-244) that affect the Direct Loan Program. On June 16, 1999, the Secretary published a notice of proposed rulemaking (NPRM) for the Direct Loan Program in the **Federal Register** (64 FR 32358). In the preamble to the NPRM, the Secretary discussed on pages 32359 and 32360 the following proposed changes:

- Amending § 685.202(a) to include the interest rate formulas that apply to Direct Subsidized, Direct Unsubsidized, and Direct PLUS Loans that are first disbursed on or after October 1, 1998 and before July 1, 2003, and to Direct Consolidation Loans that are first disbursed on or after July 1, 1998.

- Amending § 685.202(c) to reflect that the Secretary charges a loan fee on a Direct Subsidized or Direct Unsubsidized Loan not to exceed four percent of the principal amount of the loan.

- Amending § 685.211 to allow the Secretary to charge borrowers reduced interest rates to encourage on-time loan repayment.

- Moving the school selection provisions in § 685.401 to § 685.400 and removing § 685.401 from the Direct Loan Program regulations to delete all references to the phase-in of the Direct Loan Program and the transition from the Federal Family Education Loan (FFEL) Program to the Direct Loan Program.

The amendments to §§ 685.202(a), 685.400, and 685.401 reflect statutory changes that became effective on October 1, 1998, in accordance with section 3 of the 1998 Amendments. The amendments to § 685.202(c) reflect the Secretary's interpretative rule with respect to the 1998 Amendments that became effective upon its announcement in the NPRM published on June 16, 1999.

In the preamble to the NPRM, the Secretary discussed amending § 685.211 to allow the Secretary to charge borrowers reduced interest rates to encourage on-time loan repayment. This proposed amendment is not included in these final regulations. Section 455(b)(7) of the HEA includes certain requirements that must be met before final regulations on this subject are published. For example, a report from the Office of Management and Budget (OMB) on the cost neutrality of a proposed repayment incentive must be submitted to Congress not less than 60 days prior to publishing final regulations. At this time, the OMB report has not been submitted to Congress. The Secretary will publish final regulations for the repayment incentive provision once the Department has complied with the applicable statutory requirements.

Analysis of Comments and Changes

In response to the Secretary's invitation in the NPRM, several parties submitted comments on the proposed regulations. An analysis of the comments and of the changes in the regulations since publication of the NPRM follows.

We discuss substantive issues under the sections of the regulations to which they pertain. Generally, we do not address technical and other minor changes—and suggested changes the law does not authorize the Secretary to make.

Interest Rates (§ 685.202(a)(3)(i)(E) and (ii)(D))

Comments: Commenters representing guaranty agencies, lenders, and servicers in the FFEL Program

submitted joint and individual comments in which they requested that the Secretary provide further clarification on the calculation of the interest rate on a Direct Consolidation Loan for which the consolidation application is received by the Secretary on or after February 1, 1999 and before July 1, 2003. The commenters stated that there is confusion as to whether the Direct Consolidation Loan interest rate calculation is the same as the interest rate calculation for consolidation loans made under the FFEL Program. The commenters also repeated the belief they stated during negotiated rulemaking that the repayment period interest rate, rather than the in-school, grace, or deferment period interest rate, always should be used to calculate the weighted average interest rate on consolidation loans made under the Direct Loan and FFEL programs. Further, the commenters believe that Congress intended for the repayment period interest rate to be used in all cases.

Discussion: As provided in section 455(b)(6)(D) of the HEA, the interest rate on a Direct Consolidation Loan for which the consolidation application is received by the Secretary on or after February 1, 1999 and before July 1, 2003 is based on the weighted average of the interest rates on the loans being consolidated, rounded to the nearest higher one-eighth of one percent, not to exceed 8.25 percent. Section 427A(k)(4) of the HEA establishes the same interest rate formula for consolidation loans made under the FFEL Program for which the consolidation application is received by the lender on or after October 1, 1998 and before July 1, 2003.

The Secretary believes that in both the Direct Loan and FFEL programs, the weighted average interest rate should be calculated based on the interest rates that apply to the loans being consolidated at the time the loan holders complete the verification certificates. An interest rate that is lower than the repayment period rate applies to most subsidized and unsubsidized Direct Loan and FFEL program loans during the in-school, grace, and deferment periods. If, for example, a loan is in a grace period at the time the loan holder completes the verification certificate, the lower grace period interest rate would be used in the calculation of the weighted average interest rate on the consolidation loan.

To do as the commenters have suggested and always use the repayment period interest rate would mean that, in cases in which the loan being consolidated is in an in-school, grace, or deferment period, the weighted average

interest rate would be based on an interest rate that may never apply to the loan and is speculative since it would not be known when that loan would enter repayment. We know of no legal basis to support the commenters' approach and do not agree that this was the intent of Congress.

Change: None.

Loan Fees (§ 685.202(c)(1))

Comments: A number of commenters representing individual schools and associations representing schools supported the Secretary's proposed rule that would reflect the Secretary's authority to charge a loan fee not to exceed four percent on a Direct Subsidized or Direct Unsubsidized Loan. These commenters agreed with the Secretary's interpretation of the statute as discussed in the NPRM.

A number of commenters representing guaranty agencies, lenders, and services in the FFEL Program submitted joint and individual comments in which they questioned the Secretary's legal authority for proposing to amend the regulations to clarify that the Secretary may charge a loan fee not to exceed four percent on a Direct Subsidized or a Direct Unsubsidized Loan. The commenters argued that such a proposal was not consistent with the HEA.

Discussion: The Secretary continues to believe that he has the legal authority to charge a loan fee of less than four percent on the same basis as lenders in the FFEL Program. The Secretary appreciates the support provided by the commenters representing schools.

The loan fee in the Direct Loan Program is the equivalent of the three percent loan origination fee and the one percent insurance premium charged to borrowers in the FFEL Program. Prior to enactment of the 1998 Amendments, the Secretary charged borrowers the full four percent fee. This practice was generally consistent with the practice in the FFEL Program. Some Lenders charged some borrowers less than the full four percent but the HEA did not control this practice and lenders had complete discretion to offer a lower fee to some borrowers and not to others.

The 1998 Amendments made a significant change in the lender's authority to charge a lower loan origination fee to some borrowers and not others.

The 1998 Amendments made a significant change in the lender's authority to charge a lower loan origination fee to some borrowers and not others. The 1998 Amendments modified section 438(c)(2) of the HEA to establish, for the first time, legally binding standards that must be met for

a lender to reduce loan origination fees charged to borrowers in the FFEL Program. The HEA now requires lenders to provide reduced loan origination fees to all borrowers or to borrowers who demonstrate a greater financial need. The negotiated rulemaking committee reached consensus on proposed regulations that established national standards governing the reduction of loan fees. The creation of these standards under the HEA make a reduced loan fee a term and condition of the borrower's FFEL loans. A borrower now has a legal basis to insist on equal treatment from the lender on loan fees, including a lower fee, if the lender offers a lower fee to any other borrowers.

Under section 455(a) of the HEA, Direct Loan Program loans made to borrowers under the HEA "shall have the same terms, conditions, and benefits" as FFEL Program loans unless otherwise specified. As discussed above, the 1998 Amendments changed the HEA to modify the terms, conditions, and benefits of FFEL Program loans in regard to the charging of loan fees to borrowers. The Secretary believes that, under section 455(a) of the HEA, Direct Loan borrowers are entitled to a reduction in the loan fee under the same conditions as FFEL Program borrowers. Thus, the Secretary will provide a lower loan fee in the Direct Loan Program under the same conditions that govern a lender's authority to charge a reduced loan fee in the FFEL Program.

Some commenters representing lenders, guaranty agencies, and servicers in the FFEL Program argued that the authority to provide a reduced loan fee does not apply to the Direct Loan Program because section 455(c) of the HEA states that the Secretary "shall" charge a loan fee of four percent. These commenters, however, ignore the fact that their interpretation would cause a conflict between the language in section 455(c) and the requirement in section 455(a) that loans made under the Direct Loan Program "shall" have the same terms, conditions, and benefits as loans made under the FFEL Program. The commenters' interpretation would give borrowers in the FFEL Program a reduced loan fee as a term of their loan, while denying the same opportunity to borrowers in the Direct Loan Program. The Secretary is required to interpret the statute as a whole to give meaning to all statutory provisions. The Secretary's interpretation gives meaning to the requirements in both sections 455(a) and 455(c). The Secretary also notes that nothing in the 1998 Amendments or its legislative history

indicates that Congress intended to deny the opportunity for reduced loan fees provided to FFEL Program borrowers to Direct Loan Program borrowers. Accordingly, the Secretary declines to adopt the interpretation proposed by these commenters.

In commenting on the proposed rule, some commenters argued that the interpretation was inconsistent with prior interpretations of the word "shall" by the Secretary in other contexts. The examples provided by these commenters are not inconsistent with the Secretary's proposed rule in this case. In interpreting statutory language the Secretary is required to interpret the statute as a whole. In other circumstances, the Secretary has interpreted the word "shall" as denying any discretion to the Secretary when the rest of the statute does not support any other approach on a particular issue. As noted above, however, in this case, the Secretary believes that the statute as a whole supports the interpretation reflected in these regulations.

The commenters representing lenders, guaranty agencies, and servicers in the FFEL Program also argued that the Secretary should only implement a reduced loan fee in the Direct Loan Program when the HEA is changed to provide for a reduced loan fee in both programs. These comments, however, are based on a misunderstanding of the Secretary's position. The proposed rule simply applies the same new statutory provision governing reduced loan fees to borrowers in the Direct Loan Program that now applies to borrowers in the FFEL Program under section 438(c) (2) of the HEA. Thus, the Secretary's interpretation and proposed rule results in equal treatment of borrowers in both programs. In contrast, failing to apply the new rule to the Direct Loan Program would deny Direct Loan borrowers an opportunity for a reduced loan fee that is now guaranteed by statute in the FFEL Program.

In addition, we note that any statutory reduction in the fee would benefit the lender, not necessarily the borrower. The lender is required to pay the fee in the FFEL Program to the Secretary and may choose to pass the fee on to the borrower as permitted by section 438(b)(2) of the HEA. Competition in the FFEL Program has already led many lenders to offer borrowers reduced loan fees, which in turn reduces the lenders' revenues from those borrowers. Reducing the fee in the statute would simply increase the lender's profits by reducing the fee the lender is required to pay without necessarily reducing fees charged to borrowers.

Change: None.

Executive Order 12866

We have reviewed these final regulations in accordance with Executive Order 12866. Under the terms of this order, we have 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 we have determined as necessary for administering this program effectively and efficiently.

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

We have also determined that this regulatory action would not unduly interfere with State, local, and tribal governments in the exercise of their governmental functions.

We summarized the potential costs and benefits of these final regulations in the preamble to the NPRM on page 32360.

Paperwork Reduction Act of 1995

These regulations do not contain any information collection requirements.

Assessment of Educational Impact

In the NPRM, we requested comments on whether the proposed regulations would require transmission of information that any other agency or authority of the United States gathers or makes available.

Based on the response to the NPRM and on our review, we have determined that these final regulations do not require transmission of information that any other agency or authority of the United States gathers or makes available.

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(Catalog of Federal Domestic Assistance Number 84.268 William D. Ford Federal Direct Loan Program.)

List of Subjects in 34 CFR Part 685

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

Dated: August 13, 1999.

Richard W. Riley,

Secretary of Education.

For the reasons discussed in the preamble, the Secretary amends title 34 of the Code of Federal Regulations by amending part 685 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. 1087 *et seq.*, unless otherwise noted.

2. Section 685.202 is amended by revising paragraphs (a) and (c) (1) to read as follows:

§ 685.202 Charges for which Direct Loan Program borrowers are responsible.

(a) *Interest*—(1) *Interest rate for Direct Subsidized Loans and Direct Unsubsidized Loans.* (i) *Loans first disbursed before July 1, 1995.* During all periods, the interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 3.1 percentage points, but does not exceed 8.25 percent.

(ii) *Loans first disbursed on or after July 1, 1995 and before July 1, 1998.* (A) *During the in-school, grace, and deferment periods.* The interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 2.5 percentage points, but does not exceed 8.25 percent.

(B) *During all other periods.* The interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior

to that June 1 plus 3.1 percentage points, but does not exceed 8.25 percent.

(iii) *Loans first disbursed on or after July 1, 1998.* (A) *During the in-school, grace, and deferment periods.* The interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 1.7 percentage points, but does not exceed 8.25 percent.

(B) *During all other periods.* The interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 2.3 percentage points, but does not exceed 8.25 percent.

(2) *Interest rate for Direct PLUS Loans.* (i) *Loans first disbursed before July 1, 1998.* During all periods, the interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 preceding that period. The interest rate is equal to the bond equivalent rate of 52-week Treasury bills auctioned at the final auction held prior to that June 1 plus 3.1 percentage points, but does not exceed 9 percent.

(ii) *Loans first disbursed on or after July 1, 1998.* During all periods, the interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 3.1 percentage points, but does not exceed 9 percent.

(3) *Interest rate of Direct Consolidation Loans.* (i) *Interest rate for Direct Subsidized Consolidation Loans and Direct Unsubsidized Consolidation Loans.* (A) *Loans first disbursed before July 1, 1995.* The interest rate is the rate established for Direct Subsidized Loans and Direct Unsubsidized Loans in paragraph (a)(1)(i) of this section.

(B) *Loans first disbursed on or after July 1, 1995 and before July 1, 1998.* The interest rate is the rate established for Direct Subsidized Loans and Direct Unsubsidized Loans in paragraph (a)(1)(ii) of this section.

(C) *Loans for which the first disbursement is made on or after July 1, 1998 and prior to October 1, 1998, and loans for which the disbursement is*

made on or after October 1, 1998 for which the consolidation application was received by the Secretary before October 1, 1998. The interest rate is the rate established for District Subsidized Loans and Direct Unsubsidized Loans in paragraph (a)(1)(iii) of this section.

(D) *Loans for which the consolidation application is received by the Secretary on or after October 1, 1998 and before February 1, 1999.* During all periods, the interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 2.3 percentage points, but does not exceed 8.25 percent.

(E) *Loans for which the consolidation application is received by the Secretary on or after February 1, 1999.* During all periods, the interest rate is based on the weighted average of the interest rates on the loans being consolidated, rounded to the nearest higher one-eighth of one percent, but does not exceed 8.25 percent.

(ii) *Interest rate for Direct PLUS Consolidation Loans.* (A) *Loans first disbursed before July 1, 1998.* The interest rate is the rate established for

Direct PLUS Loans in paragraph (a)(2)(i) of this section.

(B) *Loans for which the first disbursement is made on or after July 1, 1998 and prior to October 1, 1998, and loans for which the disbursement is made on or after October 1, 1998 for which the consolidation application was received by the Secretary before October 1, 1998.* The interest rate is the rate established for Direct PLUS Loans in paragraph (a)(2)(ii) of this section.

(C) *Loans for which the consolidation application is received by the Secretary on or after October 1, 1998 and before February 1, 1999.* During all periods, the interest rate during any twelve-month period beginning on July 1 and ending on June 30 is determined on the June 1 immediately preceding that period. The interest rate is equal to the bond equivalent rate of 91-day Treasury bills auctioned at the final auction held prior to that June 1 plus 2.3 percentage points, but does not exceed 8.25 percent.

(D) *Loans for which the consolidation application is received by the Secretary on or after February 1, 1999.* During all periods, the interest rate is based on the weighted average of the interest rates on the loans being consolidated, rounded to the nearest higher one-eighth of one

percent, but does not exceed 8.25 percent.

* * * * *

(c) * * *

(1)(i) Charges a borrower a loan fee not to exceed four percent of the principal amount of the loan on a Direct Subsidized or Direct Unsubsidized Loan; and

(ii) Charges a borrower a loan fee of four percent of the principal amount of the loan on a Direct PLUS Loan.

* * * * *

3. Section 685.400 is amended by adding a new paragraph (d) to read as follows:

§ 685.400 School participation requirements.

* * * * *

(d) The Secretary selects schools to participate in the Direct Loan Program from among those that apply to participate and meet the requirements in paragraphs (a)(1), (b), and (c) of this section.

§ 685.401 [Removed]

4. Section 685.401 is removed and reserved.

[FR Doc. 99-21957 Filed 8-23-99; 8:45 am]

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