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Consolidation Loan Provisions in the Federal Family Education Loan and Direct Loan Programs

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Summary

The federal government operates two major student loan programs: the **Federal Family Education Loan (FFEL)** program, authorized by Part B of Title IV of the Higher Education Act (HEA), and the **William D. Ford Direct Loan (DL)** program, authorized by Part D of Title IV of the HEA. These programs provide loans to undergraduate and graduate students and the parents of undergraduate students to help them meet the costs of postsecondary education.

Under the FFEL program, loan capital is provided by private lenders, and the federal government guarantees lenders against loss through borrower default, death, permanent disability, or, in limited instances, bankruptcy. Under the DL program, the federal government provides the loans to students and their families, using federal capital (i.e., funds from the U.S. Treasury). The two programs rely on different sources of capital and different administrative structures, but essentially disburse the same set of loans: subsidized and unsubsidized Stafford loans for undergraduate and graduate students; PLUS loans for undergraduate students; and consolidation loans, which provide refinancing opportunities.

Combined annual consolidation loan volume for the FFEL and DL programs has grown dramatically in recent years, going from approximately \$5.8 billion in FY1998 to approximately \$41.6 billion in FY2003. As consolidation loan volume has grown, Congressional interest in the consolidation loan benefit has also grown. Consolidation loans received considerable attention during the 1998 reauthorization of the HEA and have subsequently been the focus of numerous legislative proposals. In general, proposals have dealt with promoting comparability in the consolidation loans available within the FFEL and DL programs, and addressing perceived competitive advantages that may have enhanced either loan program's ability to attract consolidation loan borrowers.

A complex set of provisions has been enacted to regulate competition for refinance business among loan holders within the FFEL program and across the DL and FFEL programs, and to protect borrowers — attempting to ensure they are afforded equitable refinancing options. While terms and conditions for FFEL and DL consolidation loans have become more similar in recent years, they still differ in many ways.

This report will be updated as warranted.

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Consolidation Loan Provisions in the Federal Family Education Loan and Direct Loan Programs

About This Report

This report provides comprehensive descriptive information on major provisions of the law pertaining to the consolidation loans available to federal student loan borrowers through the FFEL and DL programs. Specifically, the report summarizes the provisions of the law pertaining to each program's borrower eligibility requirements, underlying loan eligibility requirements, interest rates, authorized discounts, repayment terms, and requirements regulating borrower choice among consolidators. The report deals exclusively with provisions applicable to consolidation loans that are currently being disbursed. It will be updated as program changes are adopted, provided that it continues to be useful to provide comparative information on the consolidation loan provisions in each program.

Background

The federal government operates two major student loan programs: the **Federal Family Education Loan (FFEL)** program, authorized by Part B of Title IV of the Higher Education Act (HEA), and the **William D. Ford Direct Loan (DL)** program, authorized by Part D of Title IV of the HEA. These programs provide loans to undergraduate and graduate students and the parents of undergraduate students to help them meet the costs of postsecondary education.

Under the FFEL program, loan capital is provided by private lenders, and the federal government guarantees lenders against loss through borrower default, death, permanent disability, or, in limited instances, bankruptcy. Under the DL program, operated through the U.S. Department of Education (ED), the federal government provides the loans to students and their families, using federal capital (i.e., funds from the U.S. Treasury). The two programs rely on different sources of capital and different administrative structures, but essentially disburse the same set of loans.¹

The DL program, established in 1993, was intended to streamline the student loan delivery system and achieve cost savings. While the DL program was originally

¹ For detailed information on the array of FFEL and DL program loans, see CRS Report RL30655, *Federal Student Loans: Terms and Conditions for Borrowers*, by Adam Stoll. For a thorough discussion of how the loan programs operate, see CRS Report RL30656, *The Administration of Federal Student Loan Programs: Background and Provisions*, by Adam Stoll.

introduced to gradually expand and replace the long-standing FFEL program, the 1998 HEA amendments removed the provisions of the law that referred to a “phase in” of the DL program. Currently both programs are authorized and the two programs compete for student loan business.

The FFEL and DL programs provide the following types of loans to students and their parents:

Stafford loans (subsidized² and unsubsidized): Low interest, variable rate loans available to undergraduate and graduate students. The interest rates on these loans adjust annually, based on a statutorily established market-indexed rate setting formula, and may not exceed 8.25%.

PLUS loans: Variable rate loans available to parents of dependent undergraduate students. The interest rates on these loans adjust annually, based on a statutorily established market-indexed rate setting formula, and may not exceed 9%.

Consolidation loans: Loans that provide borrowers with refinancing options. Consolidation loans enable borrowers to simplify the repayment of loans by combining multiple loans into one. Consolidation loans also enable borrowers to lower monthly payments by extending the repayment period. Additionally, consolidation loans afford borrowers the opportunity to lock in a fixed interest rate on their student loans, based on the weighted average of the interest rates in effect on the loans being consolidated rounded up to the nearest one-eighth of 1%, capped at 8.25%.

Consolidation Loan Issues

Combined annual consolidation loan volume for the FFEL and DL programs has grown dramatically in recent years, going from approximately \$5.8 billion in FY1998 to approximately \$41.6 billion in FY2003. As consolidation loan volume has grown, congressional interest in the consolidation loan benefit has also grown. Consolidation loans received considerable attention during the 1998 reauthorization of the HEA and have subsequently been the focus of numerous legislative proposals. In general, proposals have dealt with promoting comparability in the consolidation loans available within the FFEL and DL programs, and addressing perceived competitive advantages that may have enhanced either loan program’s ability to attract consolidation loan borrowers.

A complex set of provisions has been enacted to regulate competition for refinance business among loan holders within the FFEL program and across the DL and FFEL programs; and to protect borrowers — attempting to ensure they are afforded equitable refinancing options. While terms and conditions for FFEL and DL consolidation loans have become more similar in recent years, they are still not identical. Important differences remain in the programs’ loan discounting benefits,

² To qualify for a “subsidized” Stafford loan a student must establish financial need. The federal government pays the interest on the subsidized Stafford loans while the student is in school (on at least a half-time basis) and during grace periods and deferment periods.

repayment plans, borrower choice (among consolidator) provisions, and in other areas.

This report provides descriptive information on several key features of the consolidation loans that have been central to the recent policy discourse surrounding consolidation loans. It should be noted that existing statutory and regulatory provisions pertaining to consolidation loans are widely considered to be under-specified in certain areas. In some of these areas, statutory and regulatory intent is interpreted in varying ways by participants in the loan programs. Where some debate exists about interpretation of statutory or regulatory intent, an effort is made in the text that follows to identify competing interpretations. To facilitate easy comparisons between consolidation loan provisions in each loan program, the information presented in the remainder of this report is displayed in a side by side comparative format in **Table 1**, below.³

Table 1. Comparison of Borrower Consolidation Loan Provisions in the FFEL and DL Programs

Borrower provisions	FFEL program	DL program
Borrower eligibility for consolidation loans	<p><i>Borrower eligibility for a FFEL consolidation loan:</i> A borrower is eligible for a FFEL program consolidation loan if the borrower has at least one outstanding FFEL or DL loan that is eligible for inclusion in a FFEL consolidation loan,^a and the borrower:</p> <ul style="list-style-type: none"> — Has entered the grace or repayment period on each loan he or she is seeking to consolidate.^b — Has made repayment arrangements that are satisfactory to the loan guarantor or Secretary of Education on any loan the borrower seeks to consolidate that is in default.^c — Does not have another consolidation application pending, and agrees to notify the consolidation loan holder of address changes. 	<p><i>Borrower eligibility for a DL consolidation loan:</i> A borrower is eligible for a DL program consolidation loan if the borrower has at least one outstanding DL or FFEL loan that is eligible for inclusion in a DL consolidation loan, and the borrower:</p> <ul style="list-style-type: none"> — Is seeking to consolidate loans that have been fully disbursed. — Has made repayment arrangements that are satisfactory to the loan guarantor or Secretary of Education on any loan the borrower seeks to consolidate that is in default.^c — Does not have another consolidation application pending, and agrees to notify the consolidation loan holder of address changes.

³ Statutory provisions pertaining to FFEL and DL consolidation loans can be found in Section 428C and Section 455 of the HEA, respectively. FFEL consolidation loan regulatory provisions can be found in 34 CFR 682 Sections 100-103 and 200-211. DL consolidation loan regulatory provisions can be found in 34 CFR Section 685.220.

Borrower provisions	FFEL program	DL program
	<p><i>Borrower eligibility for a FFEL joint consolidation loan:</i> Married persons, each of whom has eligible loans, are eligible for a single consolidation loan. Only one of the borrowers must meet the full set of individual eligibility requirements. However, each agrees to become jointly and severally liable for repayment of the note.^e</p>	<p>— Does not have an adverse credit history if the borrower seeks to consolidate PLUS loans.^d</p> <p><i>Borrower eligibility for a DL joint consolidation loan:</i> Married persons, each of whom has eligible loans, are eligible for a single consolidation loan. Only one of the borrowers must meet the full set of individual eligibility requirements. However, each agrees to become jointly and severally liable for repayment of the note.^e</p>
<p>Loans eligible for consolidation</p>	<p><i>Eligible loans:</i> As is noted above, a FFEL consolidation loan must be comprised of at least one eligible FFEL or DL loan. In addition, it may contain other eligible loans. All loans eligible for inclusion in a FFEL Consolidation loan are listed below:</p> <ul style="list-style-type: none"> — FFEL Stafford loans (subsidized and unsubsidized) — FFEL PLUS loans — FFEL Consolidation loans (only when combined with new loans)^f — DL Stafford loans (subsidized and unsubsidized) — DL PLUS loans — DL Consolidation loans (only when combined with new loans)^f — Federal Perkins loans — National Direct Student Loans (NDSL) — Supplemental Loans for Students (SLS)^g — Auxiliary Loans to Assist Students (ALAS)^g — Federal PLUS loans^g — Guaranteed Student Loans (GSL)^g — Federal Insured Student Loans (FISL) 	<p><i>Eligible loans:</i> As is noted above, a DL consolidation loan must be comprised of at least one eligible DL or FFEL loan. In addition, it may contain other eligible loans. All loans eligible for inclusion in a DL Consolidation loan are listed below:</p> <ul style="list-style-type: none"> — DL Stafford loans (subsidized and unsubsidized) — DL PLUS loans — DL Consolidation loans — FFEL Stafford loans (subsidized and unsubsidized) — FFEL PLUS loans — FFEL Consolidation loans — Federal Perkins loans — National Direct Student Loans (NDSL) — Supplemental Loans for Students (SLS)^g — Auxiliary Loans to Assist Students (ALAS)^g — Federal PLUS loans^g — Guaranteed Student Loans (GSL)^g — Federal Insured Student Loans (FISL)

Borrower provisions	FFEL program	DL program
	<ul style="list-style-type: none"> — National Defense Student Loans (NDSL) — Health Professional Student Loans (HPSLs) — Loans for Disadvantaged Students (LDS) — Health Education Assistance Loans (HEALs) — Public Health Service Act Nursing Student Loans (NSLs) 	<ul style="list-style-type: none"> — National Defense Student Loans (NDSL) — Health Professional Student Loans (HPSLs) — Loans for Disadvantaged Students (LDS) — Health Education Assistance Loans (HEALs) — Public Health Service Act Nursing Student Loans (NSLs)
<p>Interest rates and authorized discounts</p>	<p><i>Consolidation loan interest rates:</i> Lenders in the FFEL program may not charge borrowers interest rates that exceed the statutory maximum rate. The statutory maximum rate is a fixed rate equal to the weighted average of the interest rates on the loans consolidated rounded up to the nearest one-eighth of 1%; capped at 8.25%.</p> <p><i>Consolidation loan interest rate discounts:</i> Lenders are free to offer borrowers interest rates that are lower than the statutory maximum rates. They are also free to offer repayment incentives.</p> <p><i>Grace period consolidation rates:</i> Borrowers with Stafford loans who consolidate through the FFEL program during their grace period are able to utilize their grace period Stafford interest rates in the “weighted average” calculations that determine the fixed interest rate for the life of their consolidation loans. This amounts to a discount because the grace period interest rate is .60 percentage points lower than the in repayment rate.</p> <p><i>Consolidation of discounted loans:</i> When borrowers seek to consolidate loans that have been discounted, lenders <i>may</i> be authorized to utilize the discounted interest rates on these loans in the “weighted average” calculations that determine the borrowers’ fixed interest rate for their FFEL consolidation loans.^h</p>	<p><i>Consolidation loan interest rates:</i> ED may not charge borrowers interest rates that exceed the statutory maximum rate. The statutory maximum rate is a fixed rate equal to the weighted average of the interest rates on the loans consolidated rounded up to the nearest one-eighth of 1%; capped at 8.25%.</p> <p><i>Consolidation loan interest rate discounts:</i> ED may offer borrowers interest rate reductions to encourage on-time repayment provided that the reductions are cost-neutral to the federal government.</p> <p><i>In-school and grace period consolidation rates:</i> Borrowers with Stafford loans who consolidate through the DL program while in school or during their grace period are able to utilize their in-school/grace period Stafford interest rates in the “weighted average” calculations that determine the fixed interest rate for the life of their consolidation loans. This amounts to a discount because the in school grace period interest rate is .60 percentage points lower than the in repayment rate.</p> <p><i>Consolidation of discounted loans:</i> When borrowers seek to consolidate loans that have been discounted, ED <i>may</i> be authorized to utilize the discounted interest rates on these loans in the “weighted average” calculations that determine the borrowers’ fixed interest rate for their DL consolidation loans.ⁱ</p>

Borrower provisions	FFEL program	DL program																										
<p>Repayment terms</p>	<p><i>Repayment options:</i> FFEL lenders are authorized to offer consolidation loan borrowers standard, graduated, income sensitive, and extended repayment plans.^j Within certain boundaries, lenders are authorized to craft repayment plans they feel will be attractive to borrowers.^k</p> <p><i>Repayment period:</i> The consolidation loan repayment schedule for FFEL consolidation loans is determined by the consolidation loan balance plus the outstanding balance of any other student loans held by the borrower.^m The schedule is as follows:</p> <table border="0"> <thead> <tr> <th>Amount</th> <th>Maximum term (years)</th> </tr> </thead> <tbody> <tr> <td>Less than \$7,500.....</td> <td>10</td> </tr> <tr> <td>\$7,500 but less than \$10,000.....</td> <td>12</td> </tr> <tr> <td>\$10,000 but less than \$20,000....</td> <td>15</td> </tr> <tr> <td>\$20,000 but less than \$40,000....</td> <td>20</td> </tr> <tr> <td>\$40,000 but less than \$60,000....</td> <td>25</td> </tr> <tr> <td>\$60,000 and over.....</td> <td>30</td> </tr> </tbody> </table> <p><i>Prepayment:</i> There is no penalty for prepayment of loans. Borrowers may pay off their loans ahead of schedule and cannot be assessed charges for doing so.</p>	Amount	Maximum term (years)	Less than \$7,500.....	10	\$7,500 but less than \$10,000.....	12	\$10,000 but less than \$20,000....	15	\$20,000 but less than \$40,000....	20	\$40,000 but less than \$60,000....	25	\$60,000 and over.....	30	<p><i>Repayment options:</i> The DL program is required to allow borrowers to choose among standard, graduated, extended and income contingent repayment plans (except that income contingent repayment is not available for consolidation loans comprised of underlying PLUS loans). Within certain boundaries, ED is authorized to craft repayment plans that will be attractive to borrowers.¹</p> <p><i>Repayment period:</i> The consolidation loan repayment period varies by repayment plan. Standard repayment must occur within 10 years. Income contingent repayment occurs over a period of up to 25 years. For graduated or extended repayment the schedule is determined by the size of the consolidation loan balance plus the outstanding balance of any other student loans held by the borrower.^m The schedule is as follows:</p> <table border="0"> <thead> <tr> <th>Amount</th> <th>Maximum term (years)</th> </tr> </thead> <tbody> <tr> <td>Less than \$10,000.....</td> <td>12</td> </tr> <tr> <td>\$10,000 but less than \$20,000....</td> <td>15</td> </tr> <tr> <td>\$20,000 but less than \$40,000....</td> <td>20</td> </tr> <tr> <td>\$40,000 but less than \$60,000....</td> <td>25</td> </tr> <tr> <td>\$60,000 and over.....</td> <td>30</td> </tr> </tbody> </table> <p><i>Prepayment:</i> There is no penalty for prepayment of loans. Borrowers may pay off their loans ahead of schedule and cannot be assessed charges for doing so.</p>	Amount	Maximum term (years)	Less than \$10,000.....	12	\$10,000 but less than \$20,000....	15	\$20,000 but less than \$40,000....	20	\$40,000 but less than \$60,000....	25	\$60,000 and over.....	30
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<p>Borrower choice of consolidator</p>	<p><i>Borrower options:</i> A variety of factors determine whether a borrower is able to consolidate within the FFEL program and select among FFEL consolidation lenders. Most of these factors pertain to who holds the borrower's underlying loans. The factors that affect FFEL consolidation options are discussed below.</p> <p><i>Single lender FFEL borrowers.</i> Borrowers seeking a FFEL consolidation loan, whose underlying FFEL loans are held by a single holder, are required to first attempt to consolidate their loans with that</p>	<p><i>Borrower options:</i> A variety of factors determine whether a borrower is able to select the DL program as its consolidator. Most of these factors pertain to who holds the borrower's underlying loans. The factors that affect borrower eligibility for DL consolidation loans are discussed below.</p> <p><i>Borrowers with DL loans:</i> Borrowers seeking a DL consolidation loan comprised exclusively of underlying DL loans may pursue consolidation within the DL program.</p>																										

Borrower provisions	FFEL program	DL program
	<p>holder. If a consolidation loan is unavailable from the lender that holds the borrower’s loans or the lender does not provide the borrower with an income sensitive repayment plan acceptable to the borrower, then the borrower may pursue a FFEL consolidation loan from any other FFEL lender offering consolidation loans.</p> <p><i>FFEL borrowers with multiple lenders:</i> Borrowers whose underlying FFEL loans are held by multiple lenders, may pursue a consolidation loan through any FFEL lender offering consolidation loans.</p> <p><i>Borrowers with FFEL and DL loans:</i> Borrowers seeking to consolidate underlying FFEL and DL loans in a FFEL consolidation loan may pursue consolidation through FFEL lenders. Their ability to choose among FFEL consolidators is affected by their status as FFEL borrowers (i.e., they are bound by the single/multiple lender provisions discussed above).</p> <p><i>Borrowers with DL loans:</i> Borrowers seeking a FFEL consolidation loan that is comprised exclusively of underlying DL loans may pursue a consolidation loan through any FFEL lender.^a</p>	<p><i>Borrowers with DL and FFEL loans:</i> Borrowers seeking a DL consolidation loan comprised of underlying DL and FFEL loans may pursue consolidation within the DL program. Such borrowers are eligible for in-school consolidation through the DL program even if their in-school status is at a FFEL school.</p> <p><i>Borrowers with FFEL loans:</i> Borrowers with no underlying DL loans may pursue a DL consolidation loan consisting of underlying FFEL loans if the borrower certifies that: they have been unable to obtain a consolidation loan from a FFEL lender; or they are unable to obtain a consolidation loan with an income sensitive repayment plan acceptable to the borrower (provided the borrower is eligible for income contingent repayment).^a A borrower with outstanding FFEL loans and no DL loans is eligible for in school consolidation if the borrower is “in-school” at a school participating in the DL program.</p>

- a. There has been some debate as to whether FFEL lenders are authorized to make consolidation loans consisting exclusively of underlying DL loans. There has also been debate about whether this issue is addressed directly in statutory or regulatory provisions. In practice, FFEL lenders commonly make consolidation loans consisting exclusively of underlying DL loans.
- b. A grace period is a six-month period beginning immediately after a student ceases to be enrolled in school on at least a half-time basis. During the grace period, borrowers are not required to begin repaying their loans.
- c. Making “satisfactory repayment arrangements,” for a borrower with a defaulted FFEL or DL loan, means the defaulted borrower has made at least three voluntary on-time consecutive payments. Alternatively, a defaulted borrower may incorporate defaulted loans in a consolidation loan if they agree to repay the consolidation loan under the income sensitive repayment plan (in the FFEL program) or the income contingent repayment plan (in the DL program). It should be noted, however, that any defaulted borrower against whom a court has issued a judgement or against whom a wage garnishment order has been issued is ineligible for FFEL consolidation loans. Such borrowers may be eligible for consolidation in the DL program with the Secretary’s approval.
- d. If the borrower has an adverse credit history, the borrower must obtain an endorser for the consolidation loan or provide documentation satisfactory to the Secretary of Education of extenuating circumstances.
- e. Essentially, each borrower must meet the basic borrower eligibility requirements pertaining to their repayment, default and delinquency status on outstanding loans, however, only one borrower must meet the full set of loan eligibility requirements.
- f. Existing consolidation loans can only be included as an underlying loan in a new FFEL consolidation loan if combined with other eligible loans that have not previously been consolidated.
- g. Loans disbursed under the Guaranteed Student Loan program (formerly the name of the FFEL program). For the purposes of loan consolidation these loans count as FFEL program loans.
- h. There is some debate as to whether FFEL lenders are authorized to utilize discounted interest rates on underlying loans as the basis for calculating borrowers’ fixed interest rates for their consolidation loans. It is not clear that this issue is specifically addressed in statutory or regulatory provisions. Some lenders appear to believe they are authorized to calculate consolidation loan interest rates in this manner, and there is some indication that some lenders are doing so.
- i. There is some debate as to whether ED is authorized to utilize discounted interest rates on underlying loans as the basis for calculating borrowers’ fixed interest rates for their consolidation loans. It is not clear that this issue is specifically addressed in statutory or regulatory provisions. It appears that ED calculates consolidation loan interest rates in this manner when discounted DL loans are being incorporated in a DL consolidation loan. It is not clear, however, that the discounted rates on underlying FFEL loans (being incorporated in a DL consolidation loan) are being used in determining fixed interest rates for consolidation loans.
- j. In general, statutory and regulatory provisions are interpreted as requiring lenders to offer borrowers each repayment plan. Some lenders feel statutory and regulatory intent is under-specified in this area and that lenders are required to offer either a graduated or income sensitive repayment plan, not both.
- k. The following statutorily established provisions place some constraints on lenders’ flexibility in designing plans. Under a FFEL **graduated repayment** plan, the fixed amounts established at the beginning of repayment are to be smaller at first and larger during later years of repayment, although no payment can be more than three times greater than any other. Under an **extended repayment** plan (available only to borrowers with outstanding balances over \$30,000) fixed or graduated monthly payments may be made, and no payment can be less than \$50. Under the **income sensitive repayment** plan, borrower payments may be adjusted annually to reflect the borrowers’ income. Under a **standard repayment** plan, the borrower makes fixed monthly payments of at least \$50. **All** plans must lead to repayment within the statutorily established repayment period and require minimum payments not less than interest due.
- l. The following statutorily established provisions place some constraints on ED’s flexibility in designing plans. Under the DL **graduated repayment** plan, borrowers are to make fixed monthly payments at two or more levels, but no payments may be less than 50% or more than 150% of the monthly payment that would be required under a standard repayment plan. Under the DL **income contingent repayment** plan, repayment amounts vary annually based on the borrowers’ adjusted gross income (or other satisfactory documentation of income if adjusted gross income is not available). Under the DL **standard** and **extended repayment** plans the

borrower makes fixed monthly payments of at least \$50. Under **all** plans offered (except income contingent repayment) loan repayment must occur within a statutorily determined repayment period (or a repayment period determined by regulation) and borrower payments may not be less than interest due. For income contingent repayment, it is possible borrower payments may be less than interest due, and loans are repaid for a period of up to 25 years — with any remaining amount owed on the loan discharged at that time.

- m. If, however, the amount of the balance on “other” outstanding loans (i.e., those not being included in the consolidation loan) exceeds the outstanding balance on the loans being consolidated, then the “other” loans will not be considered in establishing a schedule.
- n. Underlying PLUS loans are not eligible for repayment under income contingent repayment, and cannot be consolidated under an income contingent repayment plan.