

principal. Most commenters supported the reduction (from three to one) in section 682.209(b)(2)(ii) of the number of full excess payments a lender must receive before the lender, absent instructions from the borrower, is authorized to interpret the borrower's intent on the handling of the prepayment and to apply them to future installment payments on the loan. Some commenters, however, objected to changing what had been a lender option in the handling of prepayments submitted without borrower instructions to a requirement that the lender treat them as intended for future installments. These commenters believe that the lender is in the best position to review the borrower's repayment pattern and to determine the borrower's intentions in making multiple payments. Several commenters also noted that they interpreted the prepayment provision of (b)(2)(ii) to apply to multiple partial payments made by the borrower that the lender accumulates as well as additional full payments. Other commenters recommended clarifying that a lender's determination of whether a prepayment amount equals one or more full scheduled payments should be made only after late charges and collection costs have been paid. These same commenters also requested that an additional sentence be added to (b)(2)(ii) to clarify that the required notice to the borrower that the borrower's due date has been advanced did not apply to borrowers making prepayments while they are in an in-school, grace, deferment, or forbearance period because they do not have a scheduled due date to which a future payment would be applied. Many commenters disagreed strongly with the requirement in (b)(2)(ii) that a lender provide the borrower with a notice informing the borrower that the payments have been applied to future installments and reminding the borrower of the repayment obligation and the next scheduled due date. The commenters believe that this requirement is overly prescriptive and burdensome to lenders and that it is unnecessary to routinely notify the borrower that the due date has been advanced. They also believe that a separate notification of this nature outside the normal billing process is confusing to borrowers, especially if the lender is generating them routinely to a borrower who continues to submit additional full payments without instructions for their handling. Many of these commenters recommended that a lender be provided the alternative of providing this information through the

use of the billing statement or coupon book rather than providing a separate notification after the funds have been applied as the regulation proposes. They indicated that borrower coupon books and billing statements are already being used to provide this kind of information.

*Discussion:* The Secretary disagrees with the one commenter that recommended that the payment application instruction in (b)(1) should be modified to clarify that a lender may apply payments in any order to late charges, collection costs, outstanding accrued interest and principal. The language on payment application was modified, at the request of lenders, in the FFEL regulations published on December 18, 1992 to clarify that a lender had the option to apply payments or prepayments to outstanding late charges, collection costs, and outstanding accrued interest before applying the remainder to principal. The Secretary believes that the provision as currently written provides lenders with the necessary flexibility in applying payments and is consistent with how the Secretary is applying payments in the Direct Loan Program.

The Secretary also disagrees that the treatment of additional full payments submitted without instructions from the borrower for their handling (e.g., multiple payment coupons enclosed with the check, a written note on the billing statement or other written instructions, or oral instructions to the lender documented in the borrower's file) should be at the option of the lender. The Secretary now believes that, absent the borrower's instruction, the most responsible approach to handling additional full payments, and the likely intent of the borrower in the majority of cases, is to apply that amount to future installment payments on the loan and to advance the borrower's next scheduled due date. In many instances, this approach will protect a borrower who has submitted a large prepayment to cover a period when he or she will not be available to make the normally scheduled payments from entering a delinquent status. Mandating this treatment of such prepayments by lenders also provides for a consistent, standardized approach for all borrowers and is consistent with the Secretary's treatment of additional full payments submitted without borrower instructions in the Direct Loan program. The Secretary also wishes to clarify that some commenters' interpretation that the provisions in (b)(2)(ii) apply to accumulated partial payments received over time from the borrower without

instructions is incorrect. The Secretary believes that a lender should only interpret that the borrower's intent, absent instructions, is to apply the excess payments to future installments if the prepayment amount submitted is at least one additional full payment. The Secretary does not believe that this is generally the borrower's intent when a borrower submits small additional amounts in excess of the scheduled payment amount. The Secretary expects these partial payment amounts, unless a lender receives specific instructions from the borrower directing the lender to accumulate them and eventually apply them to a future installment, to be applied to outstanding principal (unless the borrower has outstanding late or collection charges or outstanding accrued interest to which the lender wishes to apply the partial payment before applying the remainder to principal, as provided for under (b)(1) of this section) with no advancement of the borrower's next scheduled due date. The Secretary agrees that the determination of whether the excess payment amount is sufficient to require the handling specified in (b)(2)(ii) should be made after any late or collection charges and outstanding interest are taken care of but does not believe that this needs to be clarified in the regulations. The Secretary has made it clear that the payment application provisions in (b)(1) apply to all payments, including prepayments, so the Secretary believes any further clarification in the regulations is unnecessary. The Secretary agrees with the many commenters who recommended that the Secretary allow the use of payment coupons and billing statements as alternatives to the borrower notification required in (b)(2)(ii), provided the borrower is effectively notified of the lender's handling of the excess payment amounts and the advancement of the borrower's next scheduled due date. The Secretary also agrees that notification of the advancement of the payment due date is inappropriate for borrowers who make prepayments without instructions during in-school, grace, deferment, and forbearance periods when no payments are due.

*Changes:* The regulations have been revised in section 682.209(b)(2)(ii) to allow a lender to use a billing statement or a payment coupon book to provide information to the borrower on how the lender will treat additional full payment amounts if the borrower submits one or more additional payments without instructions to the lender as to their handling. The Secretary believes that a