Student Loan Ombudsman Caucus

Payment Application and Pre-Payment
Frequently Asked Questions

Glossary

<u>Penalty-Free Prepayment:</u> All education loans, including federal and private student loans, allow for penalty-free prepayment. This means you can make extra payments to reduce the balance of the loan, or even pay off the entire balance early, without having to pay an extra fee.

<u>Principal Balance</u>: The outstanding amount of the loan, on which the lender charges interest. As the loan is repaid, a portion of each payment is used to satisfy interest that has accrued, and the remainder of the payment is used to reduce the outstanding principal balance.

<u>Simple Daily Interest</u>: Interest is the cost for borrowing money. Simple Daily Interest can be calculated using the following formula:
(Unpaid Principal x Interest Rate) ÷ Number of Days in the Year = Approximate Daily Interest

To find out how much interest will be due each billing period, use this formula:

Approximate Daily Interest x Number of Days in Your Billing Period = Approximate Interest Due

Understanding Payment Application - FAQs

Q. How are payments applied?

A. Payment application depends on where you are in the life of your loan (in *school/deferment*, regular *repayment, enrolled in an income sensitive repayment*) and the loan type (*subsidized* – interest not responsibility of the customer during school and deferment periods or *unsubsidized* – interest continually accrues regardless of loan status). With the exception of when your account is in Income-Based Repayment (IBR) most payments are first applied to any applicable fees, charges and costs, then to the interest showing on your account as of today (or the date the payment is received) and then to your principal balance.

If your account is IBR, the payment will be applied as follows; accrued interest, collection costs, late changes and then principal. The most important thing to remember is that interest accrues daily. Also, any unpaid interest during a repayment option/deferment/forbearance period is capitalized, increasing the borrower’s principal balance. Please refer to your Promissory Note / payment disclosures or contact the lender/servicer of your loan for specific details.

Note: You can calculate the amount of interest that has accrued using the simple daily interest formula found in the resource section

Q. How can I pay my loan ahead?

A. All education loans, including federal and private student loans, allow for penalty-free prepayment. This means you can make extra payments to reduce the balance of the loan, or even pay off the entire balance early, without having to pay an extra fee.

When a lender/servicer receives payments on a loan, the payment is generally applied first to late charges and collection costs, then to outstanding interest and then to outstanding principal. Any amount beyond the amount due (e.g., the late charges and collection costs and the monthly installment as specified in the repayment schedule) is considered a prepayment. Again, it important thing to remember is that interest accrues daily.

REMINDER: You should also include written instructions with your payment should you wish your additional payment to be applied to specific loans.

Note: You can calculate the amount of interest that has accrued using the simple daily interest formula above.

Q. Why make extra payments?

A. Prepayment can save you money by paying off your loan earlier and by reducing the total interest paid over the lifetime of the loan. Since the loan balance is reduced, more of your subsequent monthly payments will go toward further reducing the loan balance and less toward interest. You should contact your lender/servicer with any specific questions regarding payment application.

Q. How Can I Request Prepayment?

A. Federal regulations allow the lender/servicer to apply a prepayment to "future installments by advancing the next payment due date" unless otherwise specified by the borrower. *For this reason, it is important to include a note with any prepayment indicating that you want the prepayment applied to reduce the principal balance of the loan. Otherwise, the lender/servicer will treat it as though you had paid your next installment(s) early, and may delay the next payment due date(s) as appropriate.*