

Issue Paper 8
Session 2: February 17 – 19, 2016

Issue: Prohibiting Loan Holder Interest Capitalization Upon Loan Rehabilitation

Statutory cite: Section 428H(e)(2) of the Higher Education Act of 1965, as amended

Regulatory cite: 34 CFR 682.202(b)(3), 682.202(b)(4), 682.410(b)(4), 685.202(b)(3)

Summary of Changes: Clarifies the conditions under which the capitalization of interest is permitted.

Changes: See regulatory text below.

§682.202 Permissible charges by lenders to borrowers.

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(b) *Capitalization.* (1) A lender may add accrued interest and unpaid insurance premiums or Federal default fees to the borrower's unpaid principal balance in accordance with this section. This increase in the principal balance of a loan is called "capitalization."

(2) Except as provided in paragraph (b)(4) and (b)(5) of this section, a lender may capitalize interest payable by the borrower that has accrued—

(i) For the period from the date the first disbursement was made to the beginning date of the in-school period or, for a PLUS loan, for the period from the date the first disbursement was made to the date the repayment period begins;

(ii) For the in-school or grace periods, or for a period needed to align repayment of an SLS with a Stafford loan, if capitalization is expressly authorized by the promissory note (or with the written consent of the borrower);

(iii) For a period of authorized deferment;

(iv) For a period of authorized forbearance; or

(v) For the period from the date the first installment payment was due until it was made.

(3)(i) A lender may capitalize accrued interest under paragraphs (b)(2)(ii) through (iv) of this section no more frequently than quarterly. Capitalization is again permitted ~~when repayment is required to begin or resume—~~

(A) Upon the expiration of the grace period;

(B) For a PLUS loan, on the date the last disbursement of the loan is made; or

(C) Upon the expiration of a period of deferment or forbearance.

(ii) A lender may capitalize accrued interest under paragraph (b)(2)-(i) and (v) of this section only on the date repayment of principal is scheduled to begin.

(4)(i) For unsubsidized Stafford loans disbursed on or after October 7, 1998 and prior to July 1, 2000, the lender may capitalize the unpaid interest that accrues on the loan according to the requirements of section 428H(e)(2) of the Act.

(ii) For Stafford loans first disbursed on or after July 1, 2000, the lender may capitalize the unpaid interest—

(A) When the loan enters repayment;

(B) At the expiration of a period of authorized deferment;

(C) At the expiration of a period of authorized forbearance; and

(D) When the borrower defaults.

(5) For Consolidation loans, the lender may capitalize interest as provided in paragraphs (b)(2) and (b)(3) of this section, except that the lender may capitalize the unpaid interest for a period of authorized in-school deferment only at the expiration of the deferment.

(6) For any borrower in an in-school or grace period or the period needed to align repayment, deferment, or forbearance status, during which the Secretary does not pay interest benefits and for which the borrower has agreed to make payments of interest, the lender may capitalize past due interest provided that the lender has notified the borrower that the borrower's failure to resolve any delinquency constitutes the borrower's consent to capitalization of delinquent interest and all interest that will accrue through the remainder of that period.

§682.410 Fiscal, administrative, and enforcement requirements.

(b) *Administrative requirements—*

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(4) *Capitalization of unpaid interest.* The guaranty agency shall capitalize any unpaid interest due the lender from the borrower at the time the agency pays a default claim to the lender, but shall not capitalize any unpaid interest thereafter.

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

(b) *Capitalization.* (1) The Secretary may add unpaid accrued interest to the borrower's unpaid principal balance. This increase in the principal balance of a loan is called "capitalization."

(2) For a Direct Unsubsidized Loan, a Direct Unsubsidized Consolidation Loan that qualifies for a grace period under the regulations that were in effect for consolidation applications received before July 1,

2006, a Direct PLUS Loan, or for a Direct Subsidized Loan for which the first disbursement is made on or after July 1, 2012, and before July 1, 2014, the Secretary may capitalize the unpaid interest that accrues on the loan when the borrower enters repayment.

(3) Notwithstanding §685.208(l)(5) and §685.209(b)(3)(iv), for a Direct Loan not eligible for interest subsidies during periods of deferment, and for all Direct Loans during periods of forbearance, the Secretary capitalizes the unpaid interest that has accrued on the loan upon the expiration of the deferment or forbearance.

(4) Except as provided in paragraph (b)(3) of this section and in §§685.208(l)(5) and 685.209(b)(3)(iv), the Secretary annually capitalizes unpaid interest when the borrower is paying under the alternative repayment plan or the income-contingent repayment plan described in §685.209(b) and the borrower's scheduled payments do not cover the interest that has accrued on the loan.