



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

**Proposed Regulatory Text for Issue Paper #3: Interest Capitalization
Session Three: December 6-10, 2021**

§ 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 or 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, or for a Direct PLUS Loan, the Secretary may capitalize the unpaid interest that accrues on the loan when the borrower enters repayment.~~

~~(23)~~ Notwithstanding § 685.208(l)(5) and § 685.209(d)(3), 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(d)(3), the Secretary annually capitalizes unpaid interest when the borrower is paying under the alternative or income-contingent repayment plans and the borrower's scheduled payments do not cover the interest that has accrued on the loan.~~

~~(5) The Secretary may capitalize unpaid interest when the borrower defaults on the loan.~~

§ 685.209 Income-contingent repayment plans.

~~(a)(2)(iv)(A)~~ Except as provided in paragraph (a)(2)(iii) of this section, accrued interest is capitalized—

~~(1) when a borrower is determined to no longer have a partial financial hardship; or~~

~~(2) At the time a borrower chooses to leave the Pay As You Earn repayment plan.~~

~~(B)(1) The amount of accrued interest capitalized under paragraph (a)(2)(iv)(A)(1) of this section is limited to 10 percent of the original principal balance at the time the borrower entered repayment under the Pay As You Earn repayment plan.~~

~~(2B) After the amount of accrued interest reaches the limit described in paragraph (a)(2)(iv)(B)(1) of this section, interest continues to accrue, but is not capitalized while the borrower remains on the Pay As You Earn repayment plan.~~

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~~(b)(3)(iv) **Limitation on capitalization of interest.** If the amount of a borrower's monthly payment is less than the accrued interest, the unpaid interest is capitalized until the outstanding principal amount is 10 percent greater than the original principal amount. After the outstanding principal amount is 10 percent greater than the original amount, interest continues to accrue but is not capitalized. For purposes of this paragraph, the original amount is the amount owed by the borrower when the borrower enters repayment.~~

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~~(c)(2)(iv) Any unpaid accrued interest is capitalized at the time a borrower leaves the REPAYE plan.~~