

THE HEALTH EDUCATION ASSISTANCE

LOAN PROGRAM

December 1985

Control # OAI-85-III-047

Region III
Philadelphia, Pennsylvania

Office of Analysis and
Inspections
Office of Inspector General
Department of Health and
Human Services

MAJOR FINDINGS

- o Reasons for bank participation in HEAL vary from guaranteed profit, to expanding customer base, to community service.
- o The number of current participating lenders is sufficient to meet the borrowing needs of HEAL students.
- o Neither schools nor lenders favor risk sharing.
 - At 10% lender risk sharing, state agencies, the majority of major banks and the Student Loan Marketing Association say they would continue participation. The discontinued participation of three major banks, however, would reduce available HEAL loan funds by nearly 30%, as compared with the FY 84 level.
 - At 20% risk sharing, over half of the current participating banks, major as well as local, say they would probably discontinue participation. This would result in at least a 36% reduction in available HEAL loan funds, as compared with FY 84.
 - Risk sharing at any level would cause participating banks to offset their potential liability by tightening loan criteria and reducing total loan volume, resulting in a further decline in available HEAL loans.
- o Banks feel that HEAL defaults could be significantly reduced by denying loans to high-risk borrowers.
- o Needy students and those in surplus disciplines are likely to be adversely affected by banks' decisions to tighten up lending criteria in response to risk sharing. Other loan sources are not available to meet the borrowing needs of these students.
- o Schools and banks have had positive results from counseling students on the long-term debt burden associated with HEAL borrowing.

INTRODUCTION

The Health Education Assistance Loan (HEAL) Program, administered by the Public Health Service (PHS), insures loans provided by non-federal lenders for students attending eligible health professions schools. Most students may borrow up to \$20,000 per year, up to a maximum of \$80,000 for all years.

Interest on HEAL loans is computed at the prevailing market rate (T-Bill rate plus 3½ percent) and accrues while the borrower is in school. Interest is compounded, and unpaid interest is added to the loan principal every six months.

Borrowers begin repayment nine months after graduation. The maximum repayment period is 25 years. Repayment may be deferred up to four years for internship or residency training, and up to three years for service in the Armed Forces, the Peace Corps or the National Health Service Corps.

In case of default, death, disability or bankruptcy, the holder of the loan is reimbursed the full amount of principal and accrued interest from the Student Loan Insurance Fund (SLIF). Deposits to the fund are derived from insurance premiums (currently 2 percent) deducted from the loan principal at the time of award.

HEAL has grown dramatically since its inception in 1978. As of September 30, 1984, over \$560 million had been loaned to over 41,000 students, and 7,969 borrowers were in repayment. An additional 332 borrowers (4% of total) were in default for \$5.2 million or 5.3% of the total \$97.4 million owed. The average HEAL indebtedness was \$13,646 per borrower.

HEAL was intended to operate without a Federal subsidy. To date, it has not been necessary to appropriate any Federal funds to maintain the SLIF.

In March 1985, the OIG Office of Audit (OA) issued a report on the HEAL program, which found that the SLIF was in danger of insolvency in FY 1985 due to insufficient insurance premiums, unnecessary student borrowing and ineffective collection efforts. The situation, if uncorrected, could result in a need for Congress to appropriate \$100 million over the next five years to cover HEAL defaults.

PHS has taken a series of corrective actions to insure the future solvency of SLIF. These include policy issuances to lenders and schools, and a comprehensive NPRM now under final development. In addition, the Administration has proposed legislation to remove the ceiling on the insurance premium, with the HHS Secretary responsible for determining the insurance premium necessary to insure solvency of the SLIF.

Nevertheless, the OIG is still concerned that despite recent and proposed corrective actions, the rising borrower default rate (averaging \$750,000 per month since December 1984) may prevent HEAL from remaining solvent in the long term.

LENDER PARTICIPATION LIMITED

Financial institutions, state agencies, pension funds and HEAL schools are eligible to become HEAL lenders. To become a participating lender, an eligible organization must submit an application for approval by the Secretary.

While over 60 institutions are currently approved HEAL lenders, most loans are being made by a few lenders. In FY 84, ten lenders disbursed over 90% of the \$237 million loaned, while 32 lenders made ten or fewer loans.

The Student Loan Marketing Association (SLMA), a Federally chartered corporation, is the nation's largest single source of financing for postsecondary education, including HEAL loans. SLMA acquires HEAL loans through the secondary purchase of loans originally made by other lenders. Loans are purchased at par at any point after the loan has been awarded. Currently, SLMA holds over 90% of all HEAL loans in repayment.

SLMA also manages the Assured Access Program, financing HEAL loans and managing them from the time of award. The Assured Access Program was the largest disburser of HEAL loans (\$66.6 million) in FY 84.

Other major lenders include the Bank of Indiana, Baybank Norfolk County Trust Co. (Massachusetts), Chase Manhattan Bank (New York), Bank One of Columbus (Ohio), and Florida Federal Savings and Loan. These banks make loans across large geographical areas, rather than confining coverage to their own state or local area. Higher education agencies in two states, Pennsylvania and Wisconsin, are also among the ten largest HEAL lenders.

RISK SHARING

On August 24, 1984, the Office of Management and Budget (OMB) issued Revised Circular A-70, "Policies and Guidelines for Federal Credit Programs." The revised circular establishes guidelines for Federal agencies to follow "in reviewing existing credit program legislation and proposing changes to such legislation." Among other provisions, A-70 requires private lenders of Federally insured loans to bear a "significant" portion (defined as at least 20%) of the risk of loss from borrower default.

The HEAL program was established in 1978 to provide 100% Federally insured loans to help meet financial needs of students in the health professions. The HEAL legislation guarantees Federal payment to the lender of 100% of the unpaid principal and interest on a defaulted loan.

In view of this contradictory situation, the Department must either propose legislation to amend the HEAL statute or request an exemption from the policy established by A-70.

PURPOSE AND APPROACH

The purpose of this inspection is to determine: 1) why so few major banks participate as HEAL lenders; 2) how to encourage greater participation by lenders; 3) the potential impact of risk sharing on HEAL; and 4) ways to reduce the borrower default rate to ensure the continued solvency of the Student Loan Insurance Fund.

The inspection is based on personal and telephone interviews with the ten largest HEAL lenders (SLMA, two state agencies and seven commercial banks), seven participating banks with limited loan activity, and five major non-participating banks. Interviews were also conducted with ten HEAL schools in six states representing six different health disciplines, as well as with private experts and organizations.

The inspection builds upon the extensive prior work done by OA and PHS, and is intended to provide additional information for use by Department officials in considering future program options.

MAJOR FINDINGS

I. BANK MOTIVES FOR HEAL PARTICIPATION DIFFER

Participating banks were asked what factors they considered in deciding whether to become HEAL lenders. The following chart shows the five responses mentioned most frequently as incentives for HEAL participation by major and local participating banks.

REASONS FOR BANK PARTICIPATION IN HEAL

REASON	MAJOR BANKS (5)	LOCAL BANKS (9)	TOTAL (14)
Round Out Portfolio	4	2	6
100% Federal Guarantee	5	4	9
Expand Customer Base	3	3	6
Service to School or Community	1	9	10
Profit	0	6	6

A. MAJOR PARTICIPATING BANKS

Of the ten largest HEAL lenders, five are commercial banks making loans across large geographical areas. These lenders cited three major reasons for participating in the HEAL program:

- o To round out student loan portfolio.
All banks contacted participate in the Guaranteed Student Loan (GSL) program, and most make loans under PLUS (parent loans and auxiliary loans to assist students). Both programs are guaranteed by the Education Department. Participating banks indicated that HEAL enables them to offer a more complete loan service to eligible students.
- o Federal guarantee offsets lower profit.
In a recent position paper, the HEAL Subcommittee of the Consumer Bankers Association (CBA) estimated that at the current interest rate (T-Bill plus 3½%), pretax profit on HEAL loans is approximately 0.90%. According to the CBA paper, the acceptable pretax return on assets for most lending institutions is approximately 1.5%.

In our survey, three major banks estimated net (after tax) HEAL profit to be approximately 0.33%, compared with about 1.0% for consumer loans. They stated they are willing to accept a lower return because the 100% Federal guarantee eliminates any risk of loss.

A recent article in the Washington Post business section cited the average return on all assets for commercial banks at about 0.67%. A representative of Moody's, an independent financial rating firm, confirmed that a lower profit, e.g., 0.33%, might be acceptable to banks because of the Federal guarantee.

- o To expand customer base at the professional level.
Banks see HEAL borrowers as a pool of potentially valuable customers with high future earnings. Their objective is to use HEAL to initiate a banking relationship which will continue after the borrower completes his education and opens a practice, even if he lives in another part of the country.

B. LOCAL PARTICIPATING BANKS

Reasons for participation were discussed with nine banks which limit loans to particular schools or geographic areas. These included seven local banks and two large lenders. Two primary reasons were cited:

- o Service to local school and community.
All nine banks mentioned service to a local school or community as a primary reason for making HEAL loans.

According to the student loan officer at one midwestern bank, "We do the banking for the local university. The feeling around here is that if the university weren't here, the town would die."

o Guaranteed Profit

Six banks cited profit as a major reason for making HEAL loans. Three of these banks sell their loans to SLMA annually or just prior to the start of repayment. They receive 100 percent of the loan balance plus all accrued interest. One small bank sees HEAL profit as favorable enough to expand its loan program. The loan officer for this bank stated, "We see HEAL as a guaranteed money maker. We have the list of HEAL schools in the midwest, and plan to send a letter to each one soliciting their HEAL business."

C. NON-PARTICIPATING BANKS

All of the major HEAL lenders are located in the eastern part of the U.S. Some time ago, PHS approached major banks in the western states to discuss the HEAL program and encourage participation. At that time, the banks declined to participate. We contacted five of these banks to learn their reasons for deciding against HEAL participation. Several factors were mentioned:

o Inadequate System

Two banks stated that at the time HEAL was discussed, they were unable to handle any additional student loan activity, because of their manual processing systems and limited staff. One of these banks has since adopted an automated system and is now interested in becoming a HEAL lender.

o Not Part of Overall Bank Strategy

Two banks cited competing demands for limited funds, low profit associated with student loans, and corporate decisions to limit existing student loan programs as factors contributing to non-participation in HEAL.

o Excessive Future Debt Burden for HEAL Borrowers

One bank stated that the high interest rates, deferred payment and long repayment period create an excessive future debt burden for HEAL borrowers which many will be unable to meet.

For example, a \$10,000 loan borrowed at 12% interest capitalized semi-annually amounts to \$25,000 after eight years of deferment. Over 15 years of repayment, the borrower would pay over \$300 per month for a total of nearly \$55,000. Most HEAL students borrow far more than \$10,000 during their four years in school. Actual repayment can extend up to 25 years. One bank officer stated, "I would

not encourage a student to get a HEAL loan because the way it is set up predisposes the student to default later on."

o Long Term and Size of Loan

One bank mentioned this as both an incentive and a disincentive for participation. On the positive side, banks find larger loans attractive because the origination costs are no higher than for smaller loans (like GSL which has an annual limit of \$5,000 for graduate students). However, the large loan size increases the risk that it will not be repaid.

A second bank stated that eight years is too long to hold a loan without receiving any payments to interest or principal.

o Infrequent Interest Collection

On most consumer loans, interest is collected every month. HEAL's semi-annual interest payment or capitalization is not attractive to one lender. For this bank, even the quarterly interest payments required under GSL are considered too infrequent.

II. CURRENT LENDERS ARE MEETING ALL HEAL BORROWING NEEDS

Two types of participation agreements, standard and comprehensive, are available to HEAL lenders. Under the standard agreement, the bank sends each application to PHS for confirmation of Federal guarantee authority prior to disbursing the loan. The comprehensive agreement allows the lender to make loans without receiving prior guarantee authority. The major HEAL lenders have comprehensive agreements.

Earlier this year, PHS notified standard lenders that the Federal guarantee authority for FY 85 had been exhausted. These banks have been unable to make HEAL loans since that time. However, HEAL borrowers have still been able to get loans from comprehensive lenders.

All participating banks and schools in our sample felt that the current lenders are sufficient to meet the borrowing needs of HEAL students. Most schools saw no reason to solicit participation from a local bank. The financial aid officer at a southern school said, "We wouldn't be interested in using our local bank for HEAL loans. Only 5% of our students are from this state, so there would be very little secondary business for the bank. We prefer dealing with a few major banks. They have systems set up and we know what kind of service to expect."

Even when a school experiences problems with one lender, there is no difficulty finding another to take its place. A school financial aid officer stated, "Loan processing delays at one major bank

caused us to change to another lender last year. Now our loans are processed within 10 days, and any questions are answered promptly."

One student aid officer indicated that while a local bank might be able to process loans faster, she was satisfied with their current lender.

While there are enough lenders to meet current HEAL borrowing needs, it appears that for small banks, the relationship with PHS may affect their decision to participate in HEAL. One example of the effect of this relationship is a midwestern bank which reported it dropped out of the program earlier this year due to excessive delays in receiving PHS guarantee authority for individual loans. This bank had been making loans to students at two local HEAL schools. Another bank noted that processing delays experienced with PHS were a problem but not serious enough for them to discontinue participation.

Some banks expressed confusion about the PHS notice that FY 85 Federal guarantee authority for HEAL loans had been exhausted. A few thought that HEAL had gone out of existence completely. Others were concerned about what they perceived as an uncertain program future. Standard lenders were awaiting word of renewed guarantee authority, so that new HEAL loans could be awarded.

III. LENDER REACTIONS TO RISK SHARING VARY

In May of this year, PHS hosted a meeting of major HEAL lenders and HEAL schools to discuss the issue of risk sharing and its applicability to HEAL. At that meeting both lenders and schools opposed risk sharing. Lenders stated that the anticipated reduction in profits associated with risk sharing could cause them to stop making HEAL loans entirely.

Lender reactions to risk sharing varied based on four factors:

1. Lender status as a commercial bank, state agency, or private non-profit corporation;
2. The size of the bank and volume of HEAL loans made;
3. The percentage of risk sharing proposed coupled with bank latitude for tightening lending criteria; and
4. Whether the lender sells loans to SLMA or keeps them in repayment.

Two levels of lender risk sharing, 10% and 20%, were discussed with 16 current participating lenders, five non-participating banks, and one bank which recently discontinued participation. Individual bank responses are presented in Appendices A through C. A summary

of reactions from the 16 participating lenders is shown in the following chart.

REACTIONS OF 16 PARTICIPATING LENDERS TO RISK SHARING

<u>% of Risk Sharing</u>	<u>Definite Drop Outs</u>	<u>Lender Size</u>	<u>Possible Drop Outs</u>	<u>Total Drop Outs</u>
10%	5 (31%)	3 major 2 local	0	5 (31%)
20%	7 (44%)	3 major 4 local	2 major	9 (56%) or 7 (44%)

All banks who found risk sharing acceptable at any level indicated that they would continue participation only if they could offset their risk by using strict loan criteria to screen out high-risk borrowers. Current HEAL regulations do not allow the use of such loan criteria by banks.

At 10% risk sharing, five lenders (31%) stated that they would drop out of the program. Two additional lenders (both small banks) indicated they would drop out at 20%. Two major lenders who would continue at the 10% risk level, would consider dropping out at 20%. If the inspection results are indicative of lender reactions nationwide, implementation of 20% lender risk sharing could mean a loss of more than half of the current participating lenders.

A. MOST MAJOR LENDERS WOULD STAY IN THE PROGRAM (See Appendix A)

SLMA voiced a continuing commitment to student loans in general and to HEAL in particular. Student loans is SLMA's business. The Assured Access Program would continue to be a major lending source, and SLMA would continue to buy HEAL loans through the secondary market. SLMA is the largest HEAL lender, disbursing over \$66 million through the Assured Access Program in FY 84.

Three major banks stated that risk sharing would cause them to stop making HEAL loans entirely. Together, these banks awarded over \$70 million in HEAL loans (nearly one-third of all HEAL funds disbursed) in FY 84. These banks do not sell their loans to SLMA. One bank is actively involved in buying HEAL loans from other banks through the secondary market.

Four large banks would continue to make HEAL loans under 10% risk sharing. Three of these banks sell most loans to SLMA prior to repayment, so are not concerned about risk sharing, as the risk transfers to SLMA at the point of sale. These four banks loaned over \$52 million in FY 84 (24% of the total amount loaned).

State higher education agencies in Pennsylvania and Wisconsin use tax-exempt bond funds to make low interest HEAL loans to state residents. These state agencies will continue making HEAL loans under risk sharing. Pennsylvania plans to sell HEAL loans to SLMA, while Wisconsin keeps them in repayment. (OMB Circular A-70 "prohibit(s) Federal guarantees of loans funded by tax-exempt obligations." However, some states now using these bonds to fund HEAL loans are currently permitted to continue the practice.)

B. LOCAL LENDERS GAVE MIXED RESPONSES (See Appendix B)

Seven banks with limited HEAL loan activity were interviewed. Of five significant responses received, one bank would continue to make loans under 20% risk sharing. Two others would drop out at 20% but would continue to participate at 10%, using tighter lending criteria. Two banks stated they would discontinue participation entirely if any risk sharing were adopted.

C. ONE NON-PARTICIPATING BANK NOW INTERESTED (See Appendix C)

Of five non-participating banks contacted, one expressed definite interest in becoming a HEAL lender, even under risk sharing, so long as tighter loan criteria could be applied. This rapidly growing bank wants to expand its customer base at the professional level, and feels that HEAL is a good vehicle for doing so. Tighter control over who would qualify for a HEAL loan is expected to reduce the probability of borrower default.

IV. IMPACT OF RISK SHARING ON HEAL

Current HEAL regulations do not allow lenders to review credit histories or apply lending criteria normally used when evaluating consumer loan applications. The proposed regulations, when finalized, will require schools to include all other aid sources (family contributions, borrower and spousal income) in calculating the amount of HEAL funds a student can borrow. Lenders will be required to review credit histories and financial aid transcripts, and to exercise "sound business judgment" in making HEAL loans.

While these measures are likely to result in smaller loans or no HEAL loans at all for some student borrowers, they are considered necessary to ensure the continued solvency of the Student Loan Insurance Fund (SLIF).

Lenders in our survey indicated that risk sharing would have a major impact on the future of the HEAL program. Four anticipated results were mentioned:

A. FEWER HEAL LOANS AVAILABLE

Five banks have indicated that any risk sharing would cause them to stop making HEAL loans. Other banks would reduce the number and size of loans awarded, using strict lending criteria

to eliminate high-risk borrowers. Banks mentioned co-signers, collateral, and a detailed risk analysis of the borrower's ability to repay based upon future projected earnings by discipline, as measures they would likely adopt under risk sharing.

SLMA's Assured Access Program would continue as a major source of HEAL loans, possibly with tighter loan criteria. Assuming continued availability of tax-exempt bond funds, students in Wisconsin and Pennsylvania could continue to receive low-interest HEAL loans through state higher education agencies.

Overall, it is anticipated that fewer HEAL loans would be available in most states due to 1) the application of strict lending criteria by banks and 2) fewer banks making HEAL loans.

The following chart shows the anticipated reduction in HEAL loan availability based on lender reactions to risk sharing.

PROBABLE REDUCTION IN HEAL LOANS UNDER RISK SHARING

% of Risk Sharing	Probable Dropouts (Major Banks)	FY 84 Lending			
		Number of Loans	% of Total	Dollars Loaned	% of Total
10%	3	9,764	28.7%	\$70.0 m.	29.5%
20%	5	11,712	34.4%	\$85.7 m.	36.2%

In FY 84, some 34,000 students borrowed over \$237 million in HEAL loan funds. Based on the survey results, 10% lender risk sharing could be expected to result in a reduction of nearly 30% in HEAL loan funds from FY 84 levels. At 20% lender risk sharing, loan funds would be reduced by 36%.

These figures do not reflect the anticipated decrease in loans by participating banks resulting from the use of tighter lending criteria. Therefore, the actual reduction in HEAL loan funds under risk sharing is likely to be much higher than 36%.

B. RESPONDENTS FEEL OTHER LOAN SOURCES WOULD NOT REPLACE HEAL

Lenders and HEAL schools were asked what other sources could be tapped if HEAL loan funds were reduced or eliminated.

o GSL and PLUS used first

Because of its high unsubsidized interest rate, HEAL is considered the loan of last resort by lenders and schools. In packaging student aid, school financial officers rely first on GSL, PLUS, institutional or state aid, and other resources, recommending a HEAL loan only after all other sources are exhausted. HEAL funds make up the difference between the standard student budget and the total of all other available resources.

- o School funds limited or nonexistent
HEAL school responses varied by professional specialty and overall wealth of the school. Medical schools appear most likely to have some limited reserves which could be used for student loans. A few medical schools have set aside funds to subsidize interest payments on HEAL loans. Dental, chiropractic and podiatry schools have virtually no reserves to devote to student aid.

- o GradEd Program complements HEAL
SLMA recently established its own private loan program, GradED, as a supplement to HEAL. Health, engineering, law and business administration graduate students may borrow up to \$7,500 per year not to exceed \$15,000 total. Interest rates are comparable to HEAL. Interest must be paid while in school and the entire loan must be repaid within 15 years. GradED requires a co-signer. Currently available in only 13 states, SLMA anticipates expansion to other states in the near future.

SLMA emphasized that GradED was established to complement HEAL, not to take its place. If changes in HEAL were to leave a major gap in loan availability, SLMA would likely modify the GradED program to help fill the gap.

- o Private loan programs considered
While all banks in our survey participate in GSL, none have established private student loan programs. Three major banks indicated that they are in the preliminary stages of considering private loan programs, which could go into effect if HEAL were discontinued. While no details are yet available, it is clear that strict loan criteria would be an integral part of any private sector student loan program.

Respondents felt that other existing sources would not be sufficient to meet student borrowing needs if HEAL funds were reduced or eliminated.

C. GREATEST IMPACT ON NEEDY STUDENTS

While not its specific focus or intent, the effect of HEAL has been to enable many students from low-income backgrounds to pursue graduate degrees in the health professions.

Schools and lenders stated unanimously that while students from middle-income families would probably be able to continue their education by being more frugal, getting part-time jobs or tapping family resources, many low-income students now in school would be forced to drop out. With lower earning ability, these non-graduates would be required to begin repayment immediately. Many would be in danger of default.

Also, because tighter lending criteria would screen out individuals considered by banks to be poor credit risks, many prospective students from low-income backgrounds would not be able to begin their graduate education at all.

Schools and banks expressed concern that risk sharing would ultimately deprive deserving low-income and minority students, as well as those from medically underserved areas, from entering the health professions. Some respondents suggested that the Department consider alternative ways to solve this possible consequence of risk sharing, e.g., direct assistance to needy students.

D. FEWER HEALTH PROFESSIONS GRADUATES IN SOME DISCIPLINES

Several lenders cited risk analysis of the borrower's future ability to repay a HEAL loan as one of the measures they would adopt under risk sharing. Lenders stated they would be less likely to make loans to students in disciplines considered by the banks to have a current or projected surplus of graduates. While not a direct intent of risk sharing, the resulting decrease in graduates in surplus disciplines is seen as a positive consequence.

V. RESPONDENT SUGGESTIONS FOR REDUCING DEFAULT

Schools and lenders, out of concern for the effect of excessive debt burden on borrowers and the future of HEAL, have suggested measures for HHS consideration. Some of these controls have been adopted by individual HEAL schools or local banks.

The following suggestions are presented in order of the frequency mentioned and the strength of impact respondents felt they would have in helping to reduce the HEAL default rate.

o More Active Counseling of Students

Both banks and schools see this as an essential step in reducing the level of borrowing as well as the future default rate. Individual schools and banks have developed handbooks, charts, and videotapes; schools include the topic in their debt management curriculum; bank loan officers and school financial aid staff hold joint orientations for new students. Respondents suggested a more active role by PHS in developing a comprehensive counseling package for HEAL borrowers.

o Encourage Interest Payments During School and Deferment.

HEAL borrowers may pay any part of the interest or principal while in school or during deferment with no penalty. Only a small percentage of borrowers take advantage of this option. Since unpaid interest is capitalized every six months, the ultimate debt burden for most borrowers far exceeds the amount originally borrowed. Banks have suggested that even partial interest payments could significantly reduce a borrower's ultimate burden, reducing the likelihood of default.

- o Reduce Maximum Annual Borrowing to \$10,000
The current limit for most HEAL borrowers is \$20,000 per year. Among banks interviewed, the average FY 84 borrowing per student ranged from \$4,000 to \$12,500. Some banks suggested that a reduced loan limit would also reduce the long-term debt burden being assumed by student borrowers, thereby reducing the probability of default.
- o Disburse HEAL Funds at Four-Month Intervals
The proposed HEAL regulations establish six months as the maximum period for which HEAL funds could be disbursed. One bank suggested that a four-month maximum would significantly reduce interest accrual over the life of the loan.
- o Use School Funds to Help Pay Interest
Some schools set aside funds to assist students with HEAL interest payments. Specific arrangements vary. One school makes low interest loans to students for this purpose. Others pay a portion of the interest for needy students. Many students who qualify for this assistance then pay the remaining interest from their own funds.
- o Report Loans to National Credit Agency Upon Disbursement
This provision took effect in California earlier this year. Reporting student loans at the time of disbursement will allow banks to control an individual's overall borrowing, whether through student loans or consumer loans, and is expected to serve as a disincentive to borrower default.
- o Eliminate Loans to First Term Students
One school's policy is not to recommend first term students for HEAL loans. The rationale is that many students are likely to drop out during the first term for other than financial reasons and that these students would be prime candidates for default.
- o Deny Transcript Requests from Delinquent Borrowers
Most HEAL borrowers are required to take state boards in order to be licensed to practice. Licensing boards require final transcripts in conjunction with the examination. One HEAL school will not release transcripts for known delinquent borrowers until payment arrangements are made. (This would affect only those borrowers who delay taking state licensing exams until after the end of the nine-month grace period.)

VI. CONCLUSIONS

The inspection found that while banks differ somewhat in their reasons for becoming HEAL lenders, the number of participating lenders have thus far been sufficient to meet the borrowing needs of HEAL students. At this point, there does not appear to be a need to solicit participation from additional lenders.

Our survey indicates that most lenders would be willing to continue HEAL participation with risk sharing at the 10% level, but only if allowed to adopt loan criteria similar to those applied to consumer loans, including credit checks, co-signers and/or collateral, and risk analysis of a potential borrower's future ability to repay. The result would be a reduction in available loan funds of nearly 30%, as compared with the FY 84 lending level.

While some banks, the Student Loan Marketing Association, and some state higher education agencies would continue to make HEAL loans at the 20% risk sharing level, the discontinued participation by most major HEAL banks could result in a reduction of over 36% of available HEAL loan funds as compared with FY 84 lending.

If risk sharing is enacted, and within the constraints of OMB Circular A-70 regarding tax-exempt bond funding of Federally guaranteed loans, PHS may wish to consider soliciting interest from higher education agencies in states with substantial HEAL borrowing as one way of filling the anticipated lending gap. Some additional non-participating banks may also be interested in becoming new HEAL lenders, as long as they have clear authority to exercise control over who receives a loan and the amounts to be loaned.

The credit check provision of the proposed HEAL regulations will result in fewer loans available for needy and other high-risk student borrowers. Risk sharing is likely to further reduce funds availability for needy students and those in surplus disciplines. Most low-income borrowers will be unable to qualify for loans if banks apply their usual lending criteria. Students in surplus disciplines may be considered poor risks because of limited future earning potential.

Lack of knowledge of the future debt consequences of HEAL borrowing causes some students to borrow more HEAL funds than absolutely needed. Through active counseling efforts by banks and schools, some students are borrowing less and repaying at least a portion of the accrued interest while in school, thereby minimizing their future debt and reducing the risk of default. PHS may wish to consider designing a program involving both banks and schools to actively counsel student borrowers on their future debt burden based on the amounts borrowed, the capitalization of interest and the long period prior to repayment.

REACTIONS TO RISK SHARING
MAJOR HEAL LENDERS

LENDER LOCATION	HEAL LOANS (% OF MADE FY 84 TOTAL)	LOANS SOLD TO SLMA?	REACTIONS TO RISK SHARING
New York (bank)	2,669 loans (7.8%) \$22.8 m. (9.6%)	No	Any risk sharing would end participation.
Indiana (bank)	6,346 loans (18.6%) \$40.7 m. (17.2%)	No	Any risk sharing would end participation.
Florida (bank)	749 loans (2.2%) \$6.5 m. (2.7%)	No	Any risk sharing would end participation.
Mass. (bank)	3,564 loans (10.5%) \$25.7 m. (10.8%)	Yes	10% or 20% risk sharing are acceptable because they sell loans to SLMA.
Ohio (bank)	1,823 loans (5.4%) \$10.7 m. (4.5%)	Yes	Risk sharing would not end participation because loans are sold to SLMA. They are considering keeping loans, and would restrict loans to local customers.
Missouri (bank)	1,501 loans (4.4%) \$10.2 m. (4.3%)	Yes	Would continue loans at 10% risk sharing, with credit checks and co-signers. At 20%, would consider leaving the program.
Iowa (bank)	447 Loans (1.3%) \$5.5 m. (2.3%)	No	10% risk sharing acceptable with tighter controls. At 20%, would consider leaving the program.
Washington, D.C.(SLMA)	10,063 loans(29.6%) \$66.6 m. (28.1%)	N.A.	Risk sharing would not affect participation.
Penna. (state agency)	949 loans (2.8%) \$7.3 m. (3.1%)	Yes	Risk sharing would not affect participation.
Wisconsin (state agency)	1,669 loans (4.9%) \$17.8 m. (7.5%)	No	Risk sharing would not affect participation.

PARTICIPATING BANKS WITH LIMITED LOAN ACTIVITY
REACTIONS TO RISK SHARING

BANK LOCATION	HEAL LOANS MADE FY 84	LOANS SOLD TO SLMA?	REACTIONS TO RISK SHARING
Ohio	54 loans \$363,000	Not Yet	-10% acceptable with tighter loan criteria. -At 20%, would drop out.
Arkansas	156 loans \$690,000	Yes	-Would drop out with any risk sharing.
Missouri	55 loans \$579,000	Yes	-Has dropped out of program. -However, risk sharing at 10% or 20% would have been acceptable.
Nebraska	7 loans \$51,000	No	-Would drop out with any risk sharing.
Minnesota	2 loans \$13,000	Not Yet	-Risk sharing okay at 10% or 20%.
Illinois	10 loans \$50,000	No	-Unsure
Iowa	4 loans \$23,000	No	-10% acceptable. -At 20%, would drop out.

NON-PARTICIPATING BANKS PREVIOUSLY CONTACTED BY PHS
REACTIONS TO RISK SHARING

BANK LOCATION	WHY NOT INTERESTED ORIGINALLY	INTERESTED NOW?	REACTION TO RISK SHARING
Arizona	Manual system - could barely handle existing student loan workload	YES	-10% or 20% okay. Primary motive is to expand customer base. -Bank would require credit checks.
California	Manual system, limited staff	MAYBE NEXT YEAR	Definitely not interested
California	-Not part of bank strategy. -Did not want to expand student loan program. -Limited loan funds available. -Limited ability to service loans.	MAYBE IN THE FUTURE	Would consider participation, but less favorably
California	-Current loan limit too high. -Future debt burden too high. -Long-term negative effect on borrower.	NO	Definitely not interested
Washington	-Profit Margin too low. -Bank decision to limit student loans	NO	Definitely not interested