Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

HEALTH EDUCATION ASSISTANCE LOAN (HEAL)

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EXECUTIVE SUMMARY

PURPOSE

The purpose of this inspection is to ascertain the degree of implementation, effectiveness and support for the recent regulatory reforms of the Health Education Assistance Loan (HEAL) program. It also assesses whether further reforms, such as performance standards and risk-sharing, are considered necessary and what their possible effectiveness might be.

BACKGROUND

This study was initiated because of high-level concerns about financial problems the HEAL program has been experiencing due to an increasing default rate. The Public Health Service (PHS) projects the Student Loan Insurance Fund (SLIF) will not have sufficient funds to pay the increasing number of claims.

The Department has, over the last few years, announced regulatory reforms to reduce the HEAL default rate and keep the SLIF solvent. These include requiring schools to conduct entrance and exit conferences and needs analyses, and having lenders conduct credit checks, exercise due diligence, including preclaim assistance, and initiate litigation where collection attempts have failed.

Performance standards and risk-sharing have both been proposed as further ways to strengthen HEAL. Lastly, and very significantly, the President's budget for Fiscal Year 1991 calls for the phasing out of the HEAL program. However, the phasing out will require Congressional action and may take many years due to the long-term nature of the loans.

METHODOLOGY

This inspection was based on: a literature review; an examination of HEAL Annual Reports; a stratified random sample of 120 school programs participating in HEAL; and information gathered from 120 financial aid officers from the sample schools and from officials of the top ten HEAL lending institutions. Contacts were also made with several Federal managers experienced in risk-sharing in other Federal programs to determine to what extent it has been effective in helping to reduce default rates.

FINDINGS

Reforms Are Widely Implemented And Generally Supported; Opinions Vary About Their Effectiveness.

The inspection found that both schools and lenders are fully implementing the recent reforms. All reforms are supported by both schools and lenders with the exception of litigation. However, preliminary evidence suggests that litigation is successful in 25 percent of the cases. Overall, both schools and lenders feel it is too soon to judge the long-term effectiveness of the reforms. Some impact has, nevertheless, already been noticed.

Most Schools And Half The Lenders Believe Performance Standards Will Be Effective; Almost All Oppose Their Use.

Although most schools object to the implementation of performance standards, more than two-thirds feel that performance standards will be either somewhat or very effective in reducing the default rate. Half the lenders agree that performance standards will be effective. This approach was successful in reducing the default rate in the Health Professions Student Loan (HPSL) program, also sponsored by the Department.

Mixed Views Exist On The Use And Value Of Risk-Sharing.

Both the schools and lenders believe schools should not be required to participate in risk-sharing and doubt that the schools' participation would be effective. However, schools see lenders in that role and feel lender participation will be effective. No lenders support risk-sharing for themselves. One-half say that they will drop out of HEAL with risk-sharing, and some mention that it would cause them to be more restrictive and limit who gets the loans. In any event, neither group feels risk-sharing is actually needed to save HEAL.

RESPONDENT RECOMMENDATIONS

When asked for suggestions on how to improve the HEAL program, schools and lenders most frequently volunteered the following innovative ideas:

- Change the terms of the loan, such as eliminating compounding interest and reducing the interest rate (which are now being done by a few lenders), and reducing the maximum loan amount and basing a tiered insurance premium on the default rate of each discipline.

- Impose stricter penalties for defaulters, such as garnisheeing wages, offsetting Medicare and Medicaid reimbursement, withholding professional licenses and providing no bankruptcy forgiveness.

- Improve communication and coordination among schools, lenders, borrowers and the Federal government.

RECOMMENDATIONS

We recommend that performance standards be implemented without delay. Our recommendation is based on predictions of schools and lenders that they will be effective, by the successful recent experience of the HPSL program with performance standards, and by our analysis of HEAL default experience to date which suggests substantial future savings with the use of performance standards. It shows that if all schools had maintained a default rate of no more than five percent it would have resulted in $20.5 million not being claimed, which represents almost 18 percent of all default dollars since the program began. These standards would be a useful tool should the program be retained and would, of course, be beneficial during a phase-out period.

COMMENTS

Comments on the draft report were received from PHS and ASPE which concur with the recommendations of this report. The PHS believes that the final rule for performance standards will be published by September 1991.

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INTRODUCTION

PURPOSE

The purpose of this inspection is to ascertain the degree of implementation, effectiveness and support for the recent regulatory reforms of the Health Education Assistance Loan (HEAL) program. It also assesses whether further reforms, such as performance standards and risk-sharing, are considered necessary and what their possible effectiveness might be.

BACKGROUND

HEAL Program

This study was initiated because of high-level concerns about financial problems the HEAL program has been experiencing.

The cost of financing an education in the health professions escalates every year. Rising tuition and living expenses make training in such fields increasingly expensive. Few students can meet these costs by relying solely upon their own or their parent's income and, therefore, most depend on loans. In response to this need, the Federal government, States and various private organizations offer loans to these students. The HEAL program, an insured-loan program administered by the Department of Health and Human Services (DHHS), is an important source of such funding.

The DHHS established the HEAL loan program in 1976. It is managed by the Public Health Service (PHS), in cooperation with participating schools and lenders. Schools determine the costs of attendance and the eligibility of applicants. Lenders make determinations of the creditworthiness of applicants, issue loans and make collections.

The HEAL program insures loans made by nonfederal lending institutions and was intended to operate without using Federal funds. It was designed to be self-sustaining by having insurance premiums deducted from the loan principal at the time of the award. These legislatively capped premiums, which have ranged from 1/4 percent to a current rate of eight percent, are deposited into the Student Loan Insurance Fund (SLIF). The SLIF reimburses the holder of the loan (typically a lending institution) for the full amount of the principal and accrued interest in event of the borrower's default, death, disability or bankruptcy.

The HEAL program allows students of medicine, dentistry, osteopathy, veterinary medicine, optometry, and podiatry to borrow up to $20,000 per year, not to exceed a total of $80,000 over the period of academic study. Students of pharmacy, chiropractic medicine, health administration and clinical psychology may borrow up to $12,500 per year, not to exceed a total of $50,000. The loans have a variable interest rate, which is capped at T-bill plus three percent and usually accrues while the student is still in school. Repayment begins nine months after graduation or after the completion of an accredited residency or other deferment not to exceed four years. The maximum repayment period is 25 years.

The HEAL program has grown dramatically since its implementation in Fiscal Year (FY) 1978, in both loans disbursed and default claims paid. Disbursements totalled $85.6 million in FY 1979, peaked in FY 1986 to $321.4 million, and then leveled off at $229.3 million in FY 1988. In FY 1989, disbursements totalled $250.6. Claim payments increased substantially from $0.2 million in FY 1979/1981 to $35.5 million in 1988, for an 1989 aggregate total of approximately $95.8 million.

Emerging Financing Problem

Although the insurance premiums have increased substantially over the years, PHS projects the SLIF will not have sufficient funds to pay the increasing number of claims. To fill this gap, the SLIF received a special appropriation of $25 million in FY 1990. The PHS feels that continuing deficits over the next few years will require further appropriations.

In response to a Congressional mandate to investigate the factors causing borrowers to default, PHS contracted with L.J. Colker & Associates and Applied Management Sciences, Inc. to conduct a study in 1988 entitled, "A Review of HEAL Defaulters: Their Causes and Corrective Measures - Part II." This study found the majority of surveyed HEAL defaulters to be between the ages of 30 and 39; male; caucasian; non-Hispanic; married or formerly married; and having an average of 1.16 dependents. Their leading occupation was chiropractic medicine. The study concluded that defaults occur not because students inappropriately select HEAL as an option, but rather because of unanticipated problems when the time came to repay the loan. These problems include delays in obtaining a license, the need to invest large sums of money when opening a practice, and not completing their professional education.

The PHS also has contracted with the Development Assistance Corporation (DAC) to design and document a forecasting model which will estimate cash flow in future years. This work has recently been completed.

Recent Changes

The Department announced regulatory reforms, effective April 1987, which are designed to reduce the HEAL default rate and keep the SLIF solvent. These reforms were based primarily upon recommendations made by the Office of Inspector General in a series of audits issued during the period 1983 to 1987. They include:

> ***Entrance and Exit Conferences.*** Schools are required to conduct entrance and exit conferences with HEAL borrowers to advise them of the terms of the loan and to educate them about repayment.

> ***Needs Analysis.*** HEAL borrowers must undergo a financial needs test by the school to determine eligibility and the loan amount for which they qualify.

Creditworthiness. The lender must now apply more stringent creditworthiness standards in determining an applicant's eligibility, including reviewing an applicant's credit history.

Due diligence. Lending institutions must prove increased due diligence in collecting the loan before filing a default claim, including: employing collection practices that are at least as extensive and as effective as those used in the collection of the lender's other loans; immediately notifying an appropriate consumer credit reporting agency regarding accounts overdue more than 60 days.

Preclaim assistance. After the lenders' attempts at collection have failed, the lender is required to notify PHS and request preclaim assistance. The PHS then sends out a series of three letters with increasingly strong language to remind the borrower to repay his/her loan.

Litigation. As of November, 1988, if the lenders' due diligence and PHS's pre-claims assistance do not result in repayment, lenders and holders are required to initiate litigation. They must refer the case to the local court and obtain a judgement against the borrower prior to submitting a default claim to PHS for payment.

Proposed Changes

Based on Public Law 100-607, effective November 4, 1988, which authorized the Secretary to establish default standards for HEAL schools, regulations will soon be proposed against which the default rates of schools, lenders and holders of loans in the secondary market will be measured. Schools, lenders and holders with a default rate above a certain percent would not be allowed to participate in the program.

In recent years, the Administration has advanced several other legislative proposals for improving HEAL, including: eliminating the eight-percent insurance premium limit; experience rating the premiums by school, lender or discipline; charging the insurance premium over the life of the loan; transferring responsibility for the loan from the Federal Government to the lender in cases of a borrower's death or disability; and extending risk-sharing for the first time to both lenders and schools, so that both would have to pay a specified percentage of an outstanding loan should one of their borrowers or students default. Prior OIG reports have supported these proposals. Thus far, Congress has declined to implement any such reforms.

Lastly, and very significantly, the President's budget for Fiscal Year 1991 calls for the phasing out of the HEAL program. However, the phasing out will require Congressional action and may take many years due to the long-term nature of the loans.

METHODOLOGY

This inspection was conducted in the following manner: a literature review was conducted and prior studies were obtained dealing with bank participation in the HEAL program, HEAL defaulters, the SLIF and possible new reforms. The HEAL Annual Reports published by PHS were reviewed. Next, a stratified random sample of 120 school programs participating in HEAL was developed with 32 allopathic medical, 29 dental, 17 chiropractic, 15 osteopathic medical, 7 podiatry and 20 other specialty programs (See Appendix A). Contacts were then made by phone and in person with both 120 financial aid officers from the sample school programs and with officials responsible for HEAL at the top ten lending institutions, which account for 94 percent of loans disbursed in FY 1989. Information was obtained from schools and lenders regarding how the new reforms have impacted on their use of the HEAL loan, and their perceptions regarding other possible reforms such as performance standards and risk-sharing. Statistics were gathered on default rates, disbursements, loan amounts and litigation. The experience with performance standards in the HPSL was analyzed. Finally, information was obtained about other Federal loan programs which have risk-sharing, and interviews were held with several Federal managers experienced in these programs to determine to what extent it has been effective in reducing default rates.

FINDINGS

REFORMS ARE WIDELY IMPLEMENTED AND GENERALLY SUPPORTED; OPINIONS VARY ABOUT THEIR EFFECTIVENESS.

➤ **Schools Have Implemented Reforms and Support Them Fully.**

Entrance and Exit Conferences

Almost all schools conduct the required entrance and exit conferences. Ninety-three percent counsel students individually or in groups on the HEAL application process, and ninety-seven percent meet with students before graduation to discuss repayment. Schools also employ other innovative counseling procedures to help lower the default rate. These include (1) computer software programs designed especially to educate students about debt management and (2) exit meetings between lenders and students to inform students about repayment.

Virtually all schools consider entrance and exit conferences and ongoing counseling as effective ways to lower the default rate. In fact, a few schools with low default rates specifically attribute their low rates to their counseling procedures. One respondent states, "We consider our entrance and exit conferences and debt counseling as substantial steps in dealing with all loan programs, not just HEAL." Many schools stress the importance of student counseling, financial planning and debt management in administering HEAL. Thirty-six percent of schools report increasing, or planning to increase, their counseling efforts despite the fact that over three-quarters of these schools have default rates lower than five percent. Over one-fifth of the schools and lenders volunteered support for extensive student counseling as a means of assuring the continuation of the HEAL program.

When asked for suggestions as to how to improve the HEAL program, 23 percent of schools and 20 percent of lenders volunteered increased student counseling and education, including maintaining contact with student borrowers after graduation. One respondent states that "consistency amongst schools in their counseling is needed - students everywhere should be told the same thing." Several schools suggest implementing a financial management program to help students handle their borrowing; one respondent states, "I would recommend every school have a financial planning seminar to reach all students." Other schools indicate that continual personal contact with students is essential to keeping them appraised of their debt and repayment obligations. Schools feel that counseling should also be extended to borrowers in residency programs.

Needs Analysis

All schools report routinely employing a needs analysis to determine HEAL eligibility and the amount of the loan. Almost two-thirds consider financial need as a major factor when recommending HEAL loans and many schools report recommending HEAL only when all other financial resources are exhausted. Almost all schools report that students consider only their need for money when applying for a HEAL loan. One respondent reflects the view of many when she says, "Students used to borrow a lot but since the needs analysis and counseling they try to borrow as little as possible, sometimes even less than they are allowed." One lender reports some decrease in HEAL usage since the needs analysis.

➤ Lenders Have Implemented All Reforms; Some Impact Already Seen.

Creditworthiness

All lenders routinely check the credit history of HEAL applicants. All but one had never run such checks prior to the recent reform. Sixty percent of lenders indicate that more stringent creditworthiness standards have decreased the number of HEAL borrowers at their institution. While most applicants are able to resolve their credit problems and obtain a HEAL loan, a majority of schools and lenders report that a small number of potential student borrowers with bad credit are ultimately rejected.

Most lenders and schools support the creditworthiness requirement. Lenders believe that credit checks prevent some high risk borrowers from taking out HEAL loans. One lender says, "We now have better customers." Both schools and lenders mention that such checks make students aware that they have a credit history and a financial responsibility to pay back HEAL loans. Seventy percent of schools feel credit checks will be effective. A majority of lenders say that credit checks will have the most impact on those students that have a credit history to assess.

Due Diligence

All lenders report exercising strong collection efforts to fulfill the due diligence requirement. Fifty percent of lenders responsible for collection of these loans believe increased due diligence such as contacts by phone or in person to secure repayment will help reduce the HEAL default rate. The remaining lenders feel that they have always been exercising due diligence. Lenders report exercising due diligence with HEAL to the same extent as with their other loans. Some mention that because of intensified collection efforts some borrowers finally file for deferment or initiate repayment.

Seventy percent of school loan officers believe due diligence will help reduce the HEAL default rate. Some loan officers who keep in contact with their borrowers feel that even stronger efforts than those required should be made by lenders to keep track of the borrower before he/she defaults. One respondent mentioned that he knew of several defaulters in his community with successful practices who the lender made no effort to go after. Schools feel due diligence increases important communication between the borrower and the lender and forces lenders to be more aggressive in their collection efforts.

Twenty-three percent of schools, when asked how to ensure the continuation of the HEAL program, volunteered that lenders need to do the best job possible in servicing the HEAL loan. These respondents support greater due diligence, stressing in particular that collection efforts are key to reducing the HEAL default rate.

Preclaim Assistance

All lenders report referring their delinquent borrowers to PHS for preclaim assistance after having exercised the required due diligence. The PHS reports that preclaim assistance was effective in obtaining cures - that is, successfully resolving the loan either with repayment, forbearance or deferment - in 93 percent of the referred cases in FY 1989. This is 18 percent more than the FY 1988 rate of 75 percent. One lender supports preclaim assistance and says, "We get deferments now and they are not turned over as defaults."

Litigation

All lenders initiate litigation against delinquent borrowers when preclaim assistance has failed. Thirty percent of lenders and forty-three percent of schools feel litigation will be effective in reducing the default rate.

Lenders report a wide range in the number of cases in litigation, from six to 2200. The PHS estimates the dollar value of cases currently in litigation to be about $73 million. Although the lenders are obtaining judgments against borrowers, the cases often do not result in successful collection efforts and PHS ends up paying the claims. Nevertheless, one major lender, who holds 60 percent of the HEAL loans, reports that 25 percent of their cases in litigation enter repayment status. Another major lender agrees when he says, "Once students are threatened with litigation 50 percent will start payment, but only half of them will probably pay."

Despite the success of litigation, lenders still have serious reservations. Lenders consider litigation an expensive process which makes it difficult to sell loans in the secondary market. One lender considers litigation "fruitless" in those cases where borrowers simply can not pay. A few lenders note that the claims paid are ultimately larger than the initial defaults because interest accrues while the case is being settled. Sixty percent of lenders report that litigation has made them reconsider their participation in the HEAL program. While many schools feel the threat of litigation might motivate some borrowers to repay, they also consider it a very costly process, to be used only as a last resort.

➤ Both Lenders and Schools Feel it is Too Soon to Judge Results of Recent Reforms

Some respondents volunteered that the recent reforms have not been implemented for a long enough time to judge their long-term effectiveness, and it will be years before the true results will be known. The current default rate is more reflective of the HEAL program prior to the implementation of the reforms. One respondent voices the concern of many when she says, "There needs to be some time given to see if the changes that have come into effect recently are working." Similarly, another respondent says, "These things take time, you can't wave a magic wand and make the rate go down."

MOST SCHOOLS AND HALF THE LENDERS BELIEVE PERFORMANCE STANDARDS WILL BE EFFECTIVE; ALMOST ALL OPPOSE THEIR USE.

More than two-thirds of schools feel that performance standards, that is not allowing schools and lenders with a default rate above a certain percent to participate in HEAL, will be either somewhat or very effective in reducing the default rate. Half the lenders agree that performance standards will be effective. Most schools and lenders feel that performance standards will force some schools out of HEAL and cause some lenders, especially the smaller ones, to leave voluntarily.

Performance standards had a positive effect on the Health Professions Student Loan program (HPSL), also sponsored by DHHS, which provides for long-term, low-interest loans to exceptionally needy students in allopathic medicine, osteopathic medicine, veterinary medicine, podiatric medicine, optometry, dentistry and pharmacy. Participating schools administer the program, collect repayments and are held to a performance standard of a five-percent default rate. The standards were first proposed in 1982 and finally implemented in 1984. Upon implementation, the PHS gave schools with default rates above five-percent six months to lower their rates by one-half. If they succeeded in doing so, they were given another six months to lower their new rate by yet another fifty percent, until they finally reached a five-percent default rate. Ultimately, fewer than seven schools were actually terminated from the program. Schools were able to successfully lower their default rates because of the following factors: they became more aggressive in their collection efforts; purchased some of their outstanding HPSL loans; and transferred some of their delinquent HPSL loans into their own institutional loan programs. In the Fall of 1985, Congress also changed the formula used to calculate the HPSL default rate, thereby reducing schools' rates, on average, by one-third.

Prior to the implementation of performance standards, HPSL had been experiencing financial difficulty. The overall HPSL default rate has decreased from 12 percent in 1981/1982, to five percent by the time performance standards were implemented, to a current rate of approximately two percent. The HPSL program is now financially sound. It is important to note that a difference between this program and HEAL is that schools have control over the collection process in HPSL.

Most schools object to performance standards being implemented. Many schools consider them unfair for several reasons: they have limited control over the default rate; while they approve HEAL applications, they are not involved in performing credit checks or in the collection process; and they have little contact with the borrower after graduation. Schools also consider unfair the possible loss of HEAL to future students who have had nothing to do with earlier default rates.

Schools voice concerns about performance standards. Many volunteer that a five-percent standard would be too low and too difficult to meet. In fact, most schools suggest that the only steps they can take to reach a five-percent default rate are increased counseling and a continuation of their current efforts. One school respondent offers, "The way to reduce default is not to slap schools' and lenders' hands if they go above the rate. The answer is education of schools and lenders about the program." Some schools are also concerned about how the default rate is calculated. One respondent suggests that the government should clarify which default rate is going to be used, adding, "I think it's ridiculous that if a person has six loans and defaults, it counts as six [defaults] instead of one." Another issue raised by schools is that other Federal educational loan programs such as the Stafford Loan program run by the Department of Education have higher performance standard rates. In the Stafford program when schools reach a 20-percent standard they must submit a compliance plan, and only if they get to a 30 percent standard are they out of the program.

Lenders also have concerns about performance standards. Eighty percent feel at least some lenders would drop out of the program with the implementation of performance standards. Some feel performance standards would limit lending because lenders would screen borrowers more carefully. They also maintain that performance standards are unfair because controlling defaults is difficult without the ability to garnish wages or withhold licenses. One lender volunteers that a five-percent standard is too tough. Sixty percent of the lenders do not envisage taking any additional steps in the future to reach this mark, because they believe they are already doing what they can to keep their default rates down.

Some schools will need to reduce their default rates with the implementation of performance standards. Table 1 below shows the results of projecting the inspection sample of 120 schools to all 310 HEAL school participants (See Appendix A). One-hundred out of the 310 schools (32 percent) have default rates which exceed five percent. Sixty-five out of 310 (21 percent) have a default rate above seven and one-half percent, and fifty schools (16 percent) exceed ten percent. Table 1 also shows the percent of 1989 dollars disbursed to these schools. An historical analysis of the deficits incurred by schools whose default rate exceeded five percent provides the following insight: If all schools had maintained a default rate of no more than five percent it would have resulted in $20.5 million not being claimed, which represents almost 18 percent of all default dollars since the program began (See Appendix B).

TABLE 1
Schools With Default Rates Above performance Standards

Performance Standard	# of schools above standard	% of schools above standard	% of 1989 HEAL $ disturbed
5%	100	32%	31%
7.5%	65	21%	14%
10%	50	16%	8%

MIXED VIEWS EXIST ON THE USE AND VALUE OF RISK-SHARING.

Although most schools do not think they should be required to participate in risk-sharing, they are evenly divided on whether their participation would be an effective tool. Most lenders agree that schools should not be required to participate in risk-sharing, but are less optimistic (30 percent) than schools as to its effectiveness. Respondents in both groups feel that schools are already doing what they can in terms of counseling and have limited control over the repayment process. Respondents also agree that schools cannot afford to pay a share of the default claims. Sixty-three percent of schools and 40 percent of lenders feel risk-sharing will cause some schools to drop out of the HEAL program.

All lenders and almost one half of schools think lenders should not be required to participate in risk-sharing. Two-thirds of the schools think lender participation in risk-sharing would help lower default rates, but ninety percent of lenders disagree. Several lenders mention that financial risk would not change the way they service HEAL loans. In contrast, schools believe lenders should incur some financial risk, because lenders have the major responsibility for the loans and profit from HEAL. Most lenders (80 percent) and schools (58 percent) do not feel risk-sharing is needed to maintain HEAL as a solvent program.

All lenders and over 90 percent of schools predict that the implementation of risk-sharing will cause some lenders to drop out of HEAL, thereby possibly ending the program. Almost half of the lenders say they definitely would drop out of the program if risk-sharing were to occur. (This is consistent with a Consumer Bankers Association study of possible risk sharing in the Stafford Loan Program. That study found that if risk-sharing were to be implemented, 45 percent of their 126 respondents say they would quit student lending altogether, and 30 percent say they would sharply curtail it.)

Respondents also cite other consequences to borrowers because of risk-sharing. They feel it would cause lenders to be more restrictive and limit who gets the loans. One lender reflects this by saying, "We would only make loans to the cream of the crop in the cream of the crop schools." This sentiment is supported by the following statement made recently by a Washington attorney speaking about risk-sharing with the Stafford Loan Program. He said, "Risk-sharing is the worst idea ever to come forward in student lending; if you're forced to carry 10% of uncovered risk, you're also going to be forced to apply traditional credit analysis to all student loan-making decisions. If risk-sharing becomes a reality, the only way the lender can avoid the risk, no matter what the percentage, is by avoiding high-risk loans. In other words, risk-sharing would defeat the whole purpose of the Stafford Loan Program: to serve students and offer a federal guarantee so students, who otherwise would not be extended credit, will have the opportunity to continue their education." Another lender of HEAL loans says, "Schools and lenders will pass on costs to students." While still another says, "... The actual outcome would be the restriction of educational access to the health professions for large numbers of Americans, particularly among the neediest and most vulnerable segments of our people."

In attempting to gauge how effective risk-sharing was in lowering default rates we examined other Federal loan programs which include this feature. These programs are administered by: the Small Business Administration, the Economic Development Administration, the Veterans

Administration, the Farmers Home Administration, the Maritime Administration and the Federal Housing Administration. With the exception of one program, all have default rates of five percent or less. These are all non-education loans which differ significantly from HEAL in that their borrowers usually have a credit history, collateral and other assets. All these programs have always had risk-sharing. One Federal manager who considers risk-sharing necessary for his program states, "I can understand [HEAL] lenders' hesitation [in accepting risk-sharing]; in educational loans there's no track record to go on." While a few Federal managers view risk-sharing favorably, most feel that it does not contribute to low default rates. Also, no manager cites risk-sharing as a reason for a low default rate in his or her program.

RESPONDENT RECOMMENDATIONS

Both schools and lenders had suggestions for improving the HEAL program. Aside from suggesting increasing student counseling and education and requiring continued comprehensive loan servicing by lenders, respondents most frequently volunteered the following innovative ideas:

1. ***Change Terms of HEAL Loan.*** Lenders (50 percent) and schools (37 percent) suggest changing the terms of the HEAL loan. These include some steps which are already being undertaken by a few lenders, such as eliminating compounding of interest or at least decreasing the frequency of compounding interest, employing graduated repayment schedules and extending forbearance and grace periods for repayment. They also include basing a tiered insurance premium on the default rate of each discipline and reducing the maximum amount of the HEAL loan. For example, one school reduced its default rate substantially by discouraging the use of HEAL for those students whose cumulative debt had reached $50,000. Schools recommend reducing the cap on the interest rate while lenders advocate eliminating it.

2. ***Impose Stricter Penalties for Defaulters.*** Lenders (50 percent) and a few schools (12 percent) suggest stricter penalties for defaulters, such as garnisheeing wages, offsetting Medicare and Medicaid reimbursement, withholding professional licenses and providing no bankruptcy forgiveness. One school states, "Don't let bankrupt borrowers be discharged from repayment; we need to work with them to keep them in the system." Another declares, "Put the onus of responsibility where it should be, on the borrower... recover the [default] through garnisheeing wages or other ways."

3. ***Improve Communication and Coordination.*** Schools (41 percent) and lenders (20 percent) mention that communication and coordination among schools, lenders, borrowers and the Federal government needs to be improved. Several schools suggest that PHS keep them routinely informed about any changes to the HEAL program, such as providing a policy and procedures manual. They also recommend that schools and lenders cooperate with each other in locating delinquent borrowers. Numerous schools suggest that coordination with the secondary market be improved, so that when lenders sell HEAL loans to these markets, borrowers know who the new holder of their loan is. They would then know where to file for deferment or forbearance or where to send their payments. One respon-

dent suggests a central clearinghouse, accessible to all lenders, be established for all borrower deferment forms. One respondent recommends instituting a one-lender rule so that borrowers are required to go to the same lender for all of their educational loans.

RECOMMENDATIONS

We recommend that performance standards be implemented without delay. Our recommendation is based on predictions of schools and lenders that they will be effective, by the successful recent experience of the HPSL program with performance standards, and by our analysis of HEAL default experience to date which suggests substantial future savings with the use of performance standards. It shows that if all schools had maintained a default rate of no more than five percent it would have resulted in $20.5 million not being claimed, which represents almost 18 percent of all default dollars since the program began. These standards would be a useful tool should the program be retained and would, of course, be beneficial during a phase-out period.

COMMENTS

Comments on the draft report were received from both PHS and ASPE which concur with the recommendations of this report. The PHS believes that the final rule for performance standards will be published by September 1991.

APPENDIX A

METHODOLOGY FOR SELECTING SAMPLE AND PROJECTING EFFECTS OF PERFORMANCE STANDARDS ON SCHOOL PARTICIPATION

One hundred and twenty schools were contacted for this inspection. These 120 are a stratified random sample of all 310 schools participating in HEAL and were selected on the basis of specialty and number of HEAL loans per school. To make national generalizations the figures from the sample were weighted. The following table gives the specialty, the total number of participating schools within each specialty (N), the total amount of HEAL money disbursed in 1989 within each specialty (TA), and the number of schools selected from each of the specialties. In addition the table shows the estimated number of schools with a default rate above 5 percent, 7.5 percent and 10 percent. This estimate was projected from the weighted sample of HEAL schools.

Specialty & Loans	Total # of Schools	Total HEAL 1989 (TA) Disburse-ments	Sample Schools	Estimated Number of Schools with a Default Rate Above:		
				5%	7.5%	10%
Medical						
Less than 80 Loans	63	$7,989,421	15	17	8	0
More than 80 Loans	57	93,647,907	15	15	4	4
Dental						
Less than 40 Loans	29	1,462,917	15	13	8	6
More than 40 Loans	28	41,721,537	15	11	7	7
Osteopathic	15	42,409,733	15	2	2	1
Chiropractic	17	26,833,776	17	10	7	4
Podiatric	7	21,770,707	7	5	3	2
Other	94	14,871,807	21	27	26	26
TOTALS	310	$250,707,805	120	100	65	50

* *Projected within each strata of the universe of 310 schools.*

APPENDIX B

METHOD FOR ESTIMATING THE DOLLAR EFFECT OF A FIVE PERCENT PERFORMANCE STANDARD

Examining default and claims experience data from PHS as of March 31, 1990 reveals that 124 out of 384 schools participating in HEAL have a historical default rate of over 5 percent. The PHS defines claims losses as defaults, bankruptcy, death and disability. Defaults losses are composed of defaults only. Based on the default rate and total default dollars of these 124 schools ($39,052,000), the total amount of dollars eligible for repayment was calculated for each school. Our calculation then showed the total amount of default dollars would have been $18,529,000 had these schools always maintained a 5 percent default rate and subtracted this figure from the actual default dollars. This difference of $20,523,000 is the amount of HEAL dollars the program could have saved had a 5 percent performance standard always been in effect. It represents approximately 18 percent of $115,984,000 in defaults paid since the program began.

APPENDIX C

COMMENTS ON THE DRAFT REPORT

DEPARTMENT OF HEALTH & HUMAN SERVICES

Cameron
Brown
[redacted]
Biehel

Public Health Service

Memorandum

Date FEB - 8 1991

From Assistant Secretary for Health

Subject PHS Comments on Office of Inspector General (OIG) Draft Report "Health Education Assistance Loan (HEAL)"

To Inspector General, OS

Attached are the PHS comments in response to the subject OIG draft report.

We concur with the report's recommendation and have initiated actions for complete implementation.

James O. Mason

James O. Mason, M.D., Dr.P.H.

Attachment

IG	✓
PDIG	✓
DIG-AS	
DIG-EI	✓
DIG-OI	
AIG-MP	✓
OGC/IG	
EX SEC	✓
DATE SENT	2/12

PUBLIC HEALTH SERVICE (PHS) COMMENTS ON THE OFFICE OF INSPECTOR GENERAL (OIG) DRAFT REPORT "HEALTH EDUCATION ASSISTANT LOAN (HEAL)" (OEI-02-90-00980)

OIG Recommendation

We recommend that performance standards be implemented without delay.

PHS Comment

We concur. A Notice of Proposed Rulemaking for the implementation of performance standards for HEAL was published in the Federal Register on October 1, 1990. The public comment period ended on November 30, 1990, and the 122 responses received are presently under review. Because of the complexity of the comments, it will take several months to complete the review, draft the appropriate Government response, and modify the draft to incorporate changes that may arise from Departmental clearances. Accordingly, we believe that the final rule should be published by September 1991. In addition to the above actions, HRSA's Bureau of Health Professions recently awarded a contract to identify and evaluate other loan default prevention strategies that may be relevant for the HEAL program.

DEPARTMENT OF HEALTH & HUMAN SERVICES Braun [redacted] Baehel

Office of the Secretary

Washington, D.C. 20201

NOV 28 1990

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TO: Richard P. Kusserow
Inspector General

FROM: Assistant Secretary for
Planning and Evaluation

SUBJECT: OIG Draft Report: "Health Education Assistance Loan (HEAL)," OEI-02-90-00980--CONCURRENCE

Thank you for the opportunity to review the draft report on the OIG study of the degree of implementation, effectiveness, and support for the recent regulatory reforms of the Health Education Assistance Loan (HEAL) program. This is an important study that provides information which will be useful to the Department, particularly now that we are examining options for legislative changes in the Department's health professions student assistance programs, including HEAL.

I concur with your general recommendation that performance standards be implemented without delay. I also find of interest the respondent recommendations, particularly those of lenders and schools regarding changing the terms of the HEAL loan (e.g., by decreasing the frequency of compounding of interest), basing a tiered insurance rate on the default rate of each discipline, and reducing the maximum amount of the HEAL loan. These are ideas that deserve serious consideration as we try to strengthen our health professions student assistance programs.

Nancy C. Silver for
Martin H. Gerry

IG	✓
PDIG	✓
DIG-AS	
DIG-EI	✓
DIG-OI	✓
AIG-MP	
OGC/IG	✓
EX SEC	
DATE SENT	11/29