STATEMENT

of the

American Medical Association

to the

Subcommittee on 21st Century Competitiveness
Committee on Education and the Workforce
U.S. House of Representatives

RE: "Consolidation Loans: What's Best for Past Borrowers, Future Students, & U.S. Taxpayers?"

July 22, 2003

On behalf of the medical student, resident physician, and physician members of the American Medical Association (AMA), we are pleased to submit this statement on the critical issue of consolidated student loans.

Introduction

In 1986, the Federal Consolidation Loan Program was established by Congress to assist student borrowers with the burden of federal student loan debt. A Federal Consolidation Loan allows an individual to consolidate his or her federal student loans into a single loan, choose a flexible repayment term and have a fixed-interest rate for the life of the loan.

The AMA strongly supports the Federal Consolidation Loan program and believes that the following should occur either during the reauthorization of the Higher Education Act (HEA) or through passage of stand-alone legislation:

- Retain the student loan consolidation program;
- Repeal the "Single-Holder" rule;
- Mandate full-disclosure of consolidated loan terms; and
- Allow borrowers to refinance their consolidated student loans at a lower interest rate.

The Federal Consolidation Loan Program Explained

The Federal Consolidation Loan program was established by Congress to assist student borrowers with the burden of federal student loan debt. The amount of a Federal Consolidation Loan reflects the total dollar amount of loans one consolidates.

According to law, each year on July 1, the Department of Education resets the student loan interest rate. The interest rate formula for consolidated loans is more favorable when consolidation occurs while one is in school, or during the six-month automatic deferment period, rather than after the six-month deferment period.

The interest rate on consolidated loans is the weighted average of the interest rate on each loan (rounded up to the nearest 1/8%), or 8.25%, whichever is less. Unless consolidated, federal student loans have variable-interest rates, which are set by the Federal Government each July. Consolidation converts the variable-interest rate to the fixed rate for the life of the loan.

Student borrowers, out-of-school borrowers and parent borrowers are all eligible to consolidate several different types of student loans. And, one may consolidate a consolidation loan only if he or she is combining that loan with at least one other eligible loan.

Lastly, Federal Regulations do not allow lenders to consolidate loans that are currently in default. A loan is considered to be in default only after a borrower fails to make payment on the loan for 270 consecutive days. Any loans that are not in default are eligible for consolidation.

Consequences of High Loan Debt

Students are taking on a tremendous burden as they move through college and graduate school in order to pursue higher education. Roughly two out of three college graduates leave college with debt. Presently, 39% of college students graduate with debt that is more than 8% of their monthly income, creating a severe financial burden on them. Within the last eight years, the student loan obligation has doubled for American students.

Medical school graduates enter their residency with an average of almost $104,000 in student loan debt. Such debt is a tremendous hardship throughout the repayment period of the loan, but it is especially difficult during the years a physician is undergoing his or her three to eight years of training in a residency program. Almost all first-year residents make less than $31,000 a year. This figure does not substantially increase throughout residency training.

When education is so costly, graduates' career choices are affected. With such high loan debt, careers serving the public often are put aside for more lucrative jobs so the loan borrower is able to pay off his or her loans. Thus, those who may be considering whether to practice medicine in an "underserved" area, enter the public health service, start a career in medical education or research, or practice primary care medicine are often deterred from such paths.

Smart Education Policy

At a time when many states are cutting their higher education budgets and more individuals are struggling to pay for a college education, we need the Federal government to assist students in obtaining their goal and the American dream of a college degree and graduate study. Keeping higher education affordable and keeping the student loan interest rates at an affordable level contributes to the United States' overall competitiveness as a nation.

When individuals make career choices based on how much money will be earned to pay back student loans, it affects how diverse the country is in terms of chosen career paths. The entire country benefits when the federal government contributes to the higher education system by offering student borrowers with affordable interest rates.

The AMA believes that it is in our national interest to encourage the best and brightest to complete their education, to be involved in the communities of this country, and to contribute to our Nation's values. One such value is to pay off our debts. Since the federal government has allowed student loan consolidation, the default rate has dropped from 22% to 5.9%. Additionally, by allowing students to lock-in today's historically low interest rates, it will assist students in lowering their overall debt load.

It is also to our country's advantage to assist individuals in obtaining a college degree because college graduates traditionally earn more money over their lifetime than those with only a high school diploma. In fact, on average, a college graduate will earn approximately one million dollars more over his/her life than those whose highest level of educational attainment is a high school diploma. Thus, it is in our nation's best interest to assist students with the financing of their degrees, so that in future years the government will reap the rewards with additional tax dollars being paid to the government. Moreover, these individuals will have more money to pump into the economy through purchases on all levels (stocks/mutual funds, real estate, entertainment, tourism, clothing, etc).

Retain the Loan Consolidation Program

The continuation and improvement of the Federal loan consolidation program in the forthcoming reauthorization of the HEA is an important issue for AMA members. This is true because of the program's critical role in enabling new physicians to manage the enormous debt they incur during their medical education. While physicians represent only a small percentage of those who consolidate student loans, consolidation is crucial to them because of their levels of indebtedness. As previously stated, the average debt for medical school graduates in 2002 was almost $104,000. This figure is up 5% from 2001. Repayment of student loan debt consumes about 20% of the average net income of starting primary care physicians (family practitioners, internists, pediatricians and general practitioners).

One consequence of the above occurrences is that many medical school graduates must go into higher paid specialties where the starting salaries are higher and they can better afford student loan repayment, which could lead to shortages of family practitioners, internists, and pediatricians. Another consequence is the inability of new physicians to practice in public hospitals and in geographic areas where their income will be insufficient to allow payment of student loan debt. By consolidating their student loan debt, new physicians can cut their payments in half. This permits new physicians to consider working in pursuits and geographic areas they could not otherwise consider if they had to repay their loans over a 10-year period versus a 15 to 30-year loan repayment period. For this reason, AMA believes that the loan consolidation program as currently structured is good public policy and should remain as part of the Higher Education Act.

Repeal the "Single-Holder" Rule and Mandate Full Disclosure of Loan Terms

The AMA supports H.R. 942/S. 835, the "Consolidation Student Loans Flexibility Act of 2003." This legislation would eliminate the "Single-Holder Rule" in the federal loan consolidation program. This would have the positive effects of broadening consumer choice and improving market competitiveness.

The current law unfairly limits consumer choice in refinancing student loans. Presently, student (and parent) loan borrowers, who want to consolidate educational loans, must refinance through their current lender when all of their loans are through a single lender. In fact, many loans of student borrowers are sold without the borrowers' knowledge. The "Single-Holder Rule" situation would be analogous to requiring homeowners wanting to refinance their mortgages to do so only with their current mortgage holders, even if the borrower did not chose the lender and if the lender did not offer the best rate and terms.

It is essential that all student loan borrowers be able to avail themselves of the best possible loan terms when seeking to refinance their debt. The “Single-Holder Rule” prevents student loan borrowers from consolidating their student loans at the lowest cost.

It is important that this provision be repealed as soon as possible during the 108th Congress. We strongly urge Congress to pass H.R. 942/S. 835 in order to eliminate this discriminatory provision in the current law.

S. 835 would also assure that loan consolidation lenders would provide notice to loan applicants regarding various terms of the consolidated loan, including the interest rate, repayment schedules, differences between variable and fixed-interest rates, and the option to prepay loan amounts. Moreover, S. 835 would guarantee that institutions of higher education would provide similar information to student loan borrowers during the exit interview. Along with elimination of the “Single-Holder” rule, we also support exit interview and loan agreements to have “clear and conspicuous” notices in accordance with S. 835.

<u>Refinance Consolidated Student Loans at a Lower Interest Rate</u>
Interest rates on student loans, including consolidated loans, are at a historically low point. Current law does not allow a student loan borrower to refinance his/her loans once consolidated, unless he/she has one (or more) outstanding qualifying loan. Thus, a borrower who consolidated a few years ago is now forced to pay a much higher interest rate than a borrower who consolidates at today’s extremely low rate. This translates into less disposable income for those who consolidated years ago, which means less money being spent to bolster the American economy.

Those who borrow money (or buy on credit) to purchase a home, automobile or home appliance are able to refinance their loans or bargain for a lower interest rate with their lender. Yet, student borrowers are unable to refinance their consolidated student loans. Obtaining a college (and beyond) education is an important American dream. Our Federal government should assist in reaching this goal by lifting restrictive laws, policies and regulations. By allowing an individual to pay less money in interest over the lifetime of his/her consolidated student loans, then he/she would have additional funds to be able to afford a home, automobile and other goods.

We urge Congress to pass legislation that would allow student loan borrowers to refinance their consolidated loans. The passage of such a law must occur in the near future, so that borrowers can take advantage of today’s historically low interest rates.

<u>Conclusion</u>
Thank you for the opportunity to submit our views regarding the Federal Student Loan Consolidation program. The AMA looks forward to working with the Subcommittee and Full Committee on finding solutions to the critical issue of financing higher education for all American students.