

HOUSE FINANCE COMMITTEE
February 25, 2009
1:48 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:48 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bill Thomas, Jr., Vice-Chair
Representative Allan Austerman
Representative Harry Crawford
Representative Anna Fairclough
Representative Richard Foster
Representative Les Gara
Representative Reggie Joule
Representative Mike Kelly
Representative Woodie Salmon

MEMBERS ABSENT

None

ALSO PRESENT

Katie Koester, Staff, Representative Paul Seaton; Diane Barrans, Executive Director, Postsecondary Education Commission, Department of Education

PRESENT VIA TELECONFERENCE

None

SUMMARY

HB 109 "An Act relating to eligibility for the Alaska supplemental education loan program and to the interest rate for a loan made under the Alaska family education loan program; and providing for an effective date."

HB 109 was REPORTED out of Committee with a "do pass" recommendation and with zero fiscal note #1 by the Department of Education and Early Development.

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#hb109

HOUSE BILL NO. 109

"An Act relating to eligibility for the Alaska supplemental education loan program and to the interest rate for a loan made under the Alaska family education loan program; and providing for an effective date."

KATIE KOESTER, STAFF, REPRESENTATIVE PAUL SEATON, related that HB 109 was brought to Representative Seaton by Diane Barrans, the director of Postsecondary Education. HB 109 requires a borrower to have good credit or a co-signer in order to apply for an Alaska Supplemental Education Loan (ASEL). This provision only applies to state loans called alternative education loans. It does not apply to federally guaranteed loans such as the Stafford Loan. Currently, a borrower can get an Alaska Student Loan as long as they do not have bad credit. A borrower with no credit could obtain a student loan. However, this has become problematic in the current fiscal climate because investors are not willing to back those loans. Alaska Commission on Postsecondary Education (ACPE) cannot use loans as they are currently structured as collateral. Without this change, the Commission will be forced to stop lending to Alaska students or the state would have to directly fund the program to the tune of approximately \$40 million to \$50 million in general fund. HB 109 also makes a small change to the Alaska Family Education Loan (FEL), a program where family members can borrow on behalf of another family member. Currently, the FEL interest rate is set in statute at 5 percent, and (ACPE) would like to allow that rate to be set by the Alaska Student Loan Corporation (ASLC) not to exceed 8.25 percent, which is the same as the ASEL.

Ms. Koester referred to informational items and articles in the members' packets. Also included are explanations of the two types of loans, the ASEL and FEL.

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DIANE BARRANS, EXECUTIVE DIRECTOR, POSTSECONDARY EDUCATION COMMISSION, DEPARTMENT OF EDUCATION, offered to answer questions related to the bill.

Representative Austerman noted that the current interest rate set for the FEL is at 5 percent. He requested information about how the bill would impact the interest rate. Ms. Barrans reported that the current rate on the ASEL is 7.3 percent. The Corporation looks each year at what level of benefit can be provided to borrowers. On a year to year basis, the Corporation approves a series of benefits. Those are generally applied as credits to reduce the effective rate of interest below 7.3 percent. For example, there is a half percent reduction for Alaska

Presence. Automated payments are given a quarter percent reduction. Timely payments reduce the interest rate another 2 percent.

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Representative Austerman asked how many students qualify for the 2.75 percent benefit. Ms. Barrans replied, with respect to the Alaska Presence benefit, about 74 percent receive the benefit. About 30 percent qualify for the automatic payment benefit. The on-time payments benefit is relatively new and less than 5 percent take advantage of it.

Representative Austerman asked if there is a revolving loan program. Ms. Barrans related that when ASLC was established in 1988, the state transferred loan assets to it into a revolving loan fund. That fund continues to exist. Repayments from the loan go into that fund, which reduces the amount of bonding needed from one year to the next.

Representative Austerman asked how large that fund was. Ms. Barrans reported that it was quite low at this point. Last year all new loans were financed out of cash coming in. By the end of this fiscal year, about \$95 million in new loans will have been funded. She speculated that by June 30 there would probably be less than \$15 million in the fund.

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Co-Chair Hawker pointed out that the transition language in the bill indicates an urgent situation. He asked for clarification as to why emergency regulations are necessary. Ms. Barrans stressed that timing was critical in order to secure financing for loans for 2009-2010, and to make a bright line between the loans that were issued under current credit standards and loans issued under an improved credit standard for 2009-2010 loans. Applications for future loans can not be accepted until the matters impacting ASLC finances are resolved.

Co-Chair Hawker rephrased that the ordinary cycle of loan processing is on hold. Ms. Barrans agreed.

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Representative Joule understood the need for the legislation; however, he spoke of a concern for students who could not qualify for loans because of a lack of credit or credit history, and without a co-signer, such as those who come from small communities. Ms. Barrans shared Representative Joule's concern. The impact is somewhat mitigated by the raising of eligibility limits on the federal Stafford Loan. There was also an increase in the base Pell Grant, and a small state grant program. There are

options for the very poor. She agreed that there would be an impact on those who have poor credit and no co-signer.

Representative Joule said it would affect both those who wish to go to vocational schools and to academic programs. Ms. Barrans pointed out that all accredited vocational schools have access to federal aid.

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Representative Crawford asked what alternative loans were. He also requested information about how a credit score is determined. Ms. Barrans explained that the term "alternative loan" is any loan that is not a federally guaranteed student loan. What used to be called the Alaska Student Loan is now called the Alaska Supplemental Education Loan, which is viewed as supplemental for gap funding. Because of lower rates, the federal guarantee, and extensive forbearance deferments repayment options under the federally guaranteed program, every student's first loan choice should be the Stafford Loan. After that, the ASEL loan would be the appropriate choice. She shared requirements of loan programs in New Jersey.

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Ms. Barrans reported that the FICO score is derived based on the consumer's history of incurring and repaying debt. She shared statistics from a sampling of 5,100 ASEL borrowers. Only a small portion had an acceptable FICO score of 680 or greater. She predicted that a great portion of new applicants would have to have co-signers. She stated a preference to not have to make the changes required in the bill. She added that some alternative loan providers have produced a risk-based scoring business model for varying interest rates. She found that method to be contrary to a program that is designed to be broadly available to Alaskan students. She explained the varying interest rate business model.

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Representative Austerman inquired about default percentages and the time period before default is declared. Ms. Barrans said that default is considered when a student is six months in arrears. The default rates have been lower in recent years. Currently, there is an 11 percent default rate. The ASLC aggressively pursues those in default.

Representative Austerman asked about costs associated with pursuing collection. Ms. Barrans described collection costs as about \$300,000 per year. Collection is cost effective because no court order is needed for garnishment.

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Co-Chair Stoltze concluded that higher default rates occurred at times where there were generous interest and forgiveness provisions. Ms. Barrans agreed. Co-Chair Stoltze said that the default rate has decreased due to "pay as you go" provisions. Ms. Barrans agreed.

Representative Austerman asked if there were any incentive programs to encourage students to stay in Alaska and work. Ms. Barrans described two modest incentives: specialized loans for teacher education and the "Winn" Brindle Memorial Scholarship Loan for fisheries-related occupations. She mentioned the Alaska Presence reduced interest rate incentive.

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Representative Gara referred to a change on page 2 of the bill, and asked if the student is required to have a good credit history now. Ms. Barrans said that is correct. Representative Gara described a scenario of a student with no credit history. Ms. Barrans explained the options that student would have: the federal Stafford loan, or obtaining a co-signer.

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Representative Gara said he was sympathetic to a concern raised in a UAA editorial and requested time to get this information to the committee.

Ms. Koester said she spoke to the reporter and maintained that the bill is a result of the current financial situation. She stressed that the legislation is time critical.

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Co-Chair Hawker said the information provided today points out a previous attitude of liberal underwriting for student loans. That, plus a national financial crisis, has led to a need for this bill. He summed up that the state must support stronger underwriting standards due to changes in international economics. The entire student loan program would end due to lack of access to capital.

Co-Chair Stoltze agreed that the bill needs to move out of committee.

Representative Gara opined that two categories of students might be affected; those without a credit history and those with bad credit. He wanted assurance that those with no credit history would not be affected.

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Ms. Barrans reiterated the results of a sampling of borrowers. For those under 21, over 81 percent had some credit history. About 22 percent had credit at or above the proposed standard. The rest would require co-signers. An acceptable FICA score is 680, which is slightly below the average credit score in Alaska.

Ms. Barrans said that she has spoken to the reporter of the UAA publication, The Northern Light, and shares a concern that some students might not be able to get a co-signer. The trade off is having a credit standard that keeps the door open for many student loan applicants and allows the program to continue to operate.

Representative Crawford understood that certain types of credit cards lower one's credit score. He spoke of his children's experience with not qualifying for student loans. He suggested that ASLC consider credit history rather than credit score. Ms. Barrans pointed out that manual reviews were problematic and not a nationally accepted review. She described the review process, which has changed in light of the recent economic crisis.

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Ms. Barrans added that one provision ensured in the regulatory process is if someone's history is impacted by a disaster or illness, there would be an appeal option. Representative Crawford thought the situation was "between a rock and a hard place".

Co-Chair Stoltze thought the agency was only using a tool necessitated by the economic crisis.

Ms. Barrans agreed that the situation is not pleasant. It would have been preferable to continue with the present model. The rating agencies are raising standards.

Co-Chair Stoltze summarized that the choices are no loans for anyone or limitations on students with no credit history. Ms. Barrans agreed, with respect to the ASEL. The exception is the Stafford loan. Co-Chair Stoltze questioned if ASLC is committed to showing students alternative financial aid opportunities. Ms. Barrans assured that ASLC is committed to working with partner institutions to try to find financial aid for Alaskan students.

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Representative Gara asked if there was a way to include in the bill those students with no credit score who are not a

credit risk as eligible for student loans. Ms. Barrens said that was the policy since 1998, but it can't continue. A demonstration of a pattern to be able to incur and repay debt is now required. Representative Gara agreed it was a difficult situation. He shared that he would not have qualified for student loans under this proposed legislation.

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Co-Chair Hawker noted a zero fiscal note by the Department of Education and Early Development.

Representative Austerman MOVED to REPORT HB 109 out of Committee with individual recommendations and the accompanying fiscal note.

HB 109 was REPORTED out of Committee with a "do pass" recommendation and with zero fiscal note #1 by the Department of Education and Early Development.

There being NO OBJECTION, it was so ordered.

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ADJOURNMENT

The meeting was adjourned at 2:33 PM.