

HVB

506

SENATE COMMITTEE REPORT

DATE: 4/15/94

FURTHER: Finance

DATE TURNED INTO OFFICE: 4/30/94

HES Committee considered CS FOR HOUSE BILL NO. 506(FIN) am

"An Act relating to student loans; to sanctions for defaulting on a student loan, including denial of a state occupational license; and providing for an effective date."

and recommends:

- replace with _____ CS _____ ()
- or adopt previous _____ CS _____ ()
- attaches amendment(s)

- same title
- new title
- technical title change (HB only)

adopts _____ Letter of Intent

further referral to the _____

- do pass
- do not pass
- no recommendation
- individual recommendations

NEW FISCAL NOTES

Department	Date	Zero	Fiscal
AK Com on Postsec. Edu.	4/15/94		99.7
Administration	4/15/94	✓	

PREVIOUS FISCAL NOTES

Department	Date	Zero	Fiscal
AK Com on Postsec. Edu.	4/15/94		157.2

Appropriation No Fiscal Note

DO PASS:

Lawrence A. Roman
John M. ...

OTHER RECOMMENDATIONS:

Mike Fuller No Rec
J. ... No Rec

Steve King Do Not Pass
 Chair: Signature and Recommendation



House of Representatives

**SPONSOR STATEMENT
CSHB506 (FIN)**

“An Act relating to student loans; to sanctions for defaulting on a student loan, including denial of a state occupational license; and providing for an effective date.”

HB 506 authorizes variable interest rates on student loans. The annual interest on Alaska Student Loans will be set each year by adding to the true interest rate for that year's tax exempt bonds an additional percentage (not to exceed 2.5%) designed to cover the administrative costs of the program.

Included in this proposed legislation is a section that would make Alaska Student Loan applicants ineligible to receive a new student loan for five years if any portion of a previous Alaska Student Loan has been discharged or written-off for any reason.

HB 506 authorizes income withholding for borrowers in default on their Alaska Student Loans. Any judgements or court orders regarding a defaulted borrower must contain an income withholding order.

Borrowers in default on their Alaska Student Loans would be ineligible to renew an existing license to do business or practice an occupation in Alaska until the Department of Commerce is notified by the Commission that the applicant's loan account has been brought current. "Current" means the person in default has made arrangements in good faith to pay the amount owed.

This legislation will give borrowers the option to consolidate variable term loans into a single loan. The interest rate on the loan would be the weighted average of all loans included in the consolidation. A married couple may consolidate their individual loans if they agree to be held jointly and separately liable for repayment of the refinanced loan regardless of the amount of their previous individual debts, and in spite of any future change in their marital status. The loan is not dischargeable in the event that one spouse dies.

Finally, this bill expands the Family Education Loan Eligibility by removing the dependency requirement. This would allow one family member to borrow on behalf of another member of their immediate family. The removal of the dependency requirement will make it clear that it is the borrower "only" who must meet the Alaska residency requirement.

This legislation is necessary to protect the future of our Alaska State Student Loan program. I urge favorable consideration by the committee members.

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. CS HB 506 (FIN) am

Revision Date: 04 -18- 94
 Title: An Act relating to student loans;to sanctions
for defaulting on a student loan, including denial of a state . . .
 Sponsor: House HESS by Request
 Requestor: Senate HES Committee

Dept Affected: Alaska Commission on Postsecondary Education
 BRU: Alaska Student Loan Corporation.
 Component: Student Loan Program

COMPONENT SERIAL NO. 218

Expenditures/Revenues	(thousands)					
OPERATING EXPENDITURES	FY95	FY96	FY97	FY98	FY99	FY00
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	99.7	91.7	91.7	91.7	91.7	91.7
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	99.7	91.7	91.7	91.7	91.7	91.7
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGES IN REVENUES (1022)	1,408.3	1,451.9	1,534.2	1,621.5	1,714.3	1,812.6

FUND SOURCE

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other Fund 1022	99.7	91.7	91.7	91.7	91.7	91.7
TOTAL	99.7	91.7	91.7	91.7	91.7	91.7

0.0

Estimate of any current year (FY94) costs (\$): _____

POSITIONS

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS (Attach a separate page if necessary): Fiscal analysis of this bill is presented by bill section:

Section 1: this section directs Alaska Department of Commerce and Economic Development to withhold renewal of professional licenses upon notice from ACPE that a person has defaulted on an Alaskan Student Loan. Estimated cost to the ACPE to provide such notice:

FY95	FY96	FY97	FY98	FY99	FY00
0.0	0.0	0.0	0.0	0.0	0.0

(continued on reverse)

Prepared by: Diane M. Barrans
 Division: Alaska Commission on Postsecondary Education

Phone Number: (907) 465-6743
 Date: 4/18/94

Approved by Commissioner: Joe L. McCormick, Executive Director
 Agency: Alaska Commission on Postsecondary Education

Date: 4/18/94

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HB 506 Analysis (continued):

Section 2: this section creates a variable interest rate that is tied to the cost of money.

NO Fiscal Impact. Zero (0) fiscal note.

Section 3: this section amends the provisions defining the actions of the Commission if a loan is in default.

NO Fiscal Impact. Zero (0) fiscal note.

Section 4: this section provides for loan consolidation.

NO Fiscal Impact. Zero (0) fiscal note.

Section 5: this section changes eligibility for ASL if applicant has had a previous loan discharged through bankruptcy proceedings.

NO Fiscal Impact. Zero (0) fiscal note.

Section 6: this section provides for assignment of wages on a defaulted loan.

NO Fiscal Impact. Zero (0) fiscal note.

Section 7 and Section 8: these sections amend the requirements for family education loans.

NO Fiscal Impact. Zero (0) fiscal note.

These changes to the loan servicing will create significant opportunities for operational efficiencies and, more importantly, enhance the collection efforts of the program and increase the flow of student loan receipts. The following estimate of increased receipts as a result of these changes is based upon the following assumptions: 1) collection on defaulted loans increases 5 percent per year as a result of the assignment of wages and Commerce's withholding on renewal of professional licenses; 2) loan consolidation will reduce the number of loans going into default by 15 percent; and 3) loan consolidation will improve collection (accounts not going into default) by 2 percent per year.

Estimated increased revenues to the Corporation:

	in thousands					
	FY95	FY96	FY97	FY98	FY99	FY00
1) Increased collection vendor	208.3	215.9	235.7	257.3	281.0	306.8
2) loan consolidation	<u>1,200.0</u>	<u>1,236.0</u>	<u>1,298.5</u>	<u>1,364.2</u>	<u>1,433.3</u>	<u>1,505.8</u>
Total	1,408.3	1,451.9	1,534.2	1,621.5	1,714.3	1,812.6

Costs based on interagency RSA with Department of Commerce and Economic Development.

POSITION PAPER ON CSHB506(FIN) am
Alaska Commission on Postsecondary Education
April 15, 1994

House Bill 506--an act relating to student loans and to sanctions for defaulting on a student loan--was introduced by the House Committee on Health, Education and Social Services at the request of the Alaska Commission on Postsecondary Education (ACPE). The legislation has been crafted to address several significant administrative problems of the Alaska Student Loan program specifically, the need to protect an eroding capital base by increasing loan repayment and by lending at rates which reflect costs of capital.

This paper provided the context within which the bill should be considered as well as the rationale for each of the sections.

BACKGROUND

The Alaska Student Loan Program (ASL) began in 1971 as a student assistance program supported by the state General Fund. The program grew out of a widely-expressed desire that the state's new oil wealth be used, in part, to increase educational opportunities for Alaska students. For the first decade and a half, the program was generously supported by general fund appropriations. However, as oil prices and state oil revenues declined, full state funding could no longer be assured and a separate state entity--the Alaska Student Loan Corporation--was established by the legislature to raise alternative financing in the form of tax-exempt bonding. Since the first bond sale in spring of 1988, the Corporation has raised more than \$250 million in private capital markets to support student loans.

Over its 20 plus years of existence, the ASL program has undergone numerous legislative changes;

- loan maximums have been raised from \$2,500 to \$5,500 for undergraduate study;
- loan interest rates have increased from 5% to 8%;
- the loan repayment period has been extended from 6 to 10 years; and
- forgiveness benefits for those borrowers returning to the state have gone from 40% to 50% and then to zero.

By and large, program changes from 1971 to 1986 were made to benefit students by providing easier access to larger amounts of postsecondary education aid. although the program was originally created as a revolving loan fund, provisions such as forgiveness and interest subsidies while the student remained in school assured that the fund could not continue without infusions of state support. In 1986, forgiveness benefits were ended and interest subsidies reduced in an attempt to cut back--but not eliminate--this drain on state resources.

With the advent of private funding through tax-exempt bonds, the ASL began to shift from a student-centered program to one responsible to bondholders. Loan conditions which resulted in losses to fund principle or to earned interest--such as forgiveness provisions and in-school interest subsidies--could be continued only with state general fund appropriations to replace losses. Although such appropriations did continue through

FY92, the amount of the appropriation was never related to the losses incurred by mandate loan conditions. Today, the fund receives no state support. Thus, the student loan fund continues to expense forgiveness and interest subsidy benefits with no compensating revenue source.

Bad debts are a further drain on the capital base. The program has succeeded in reducing its default rates from the high levels of the mid-1980's; however, it continues to write off a portion of its portfolio as non-performing. In addition, some loans must be canceled because of death or disability of the borrower. The following table shows the annual and cumulative effect of the forgiveness and write off provisions since the program transitioned to bond funding.

TABLE 1
Losses to the Alaska Student Loan Fund

Fiscal Year	Forgiveness	Loan Write-Offs
FY88	\$5,612.5	\$500.0
FY89	\$6,050.6	\$800.0
FY90	\$6,598.2	\$5,001.0
FY91	\$8,801.4	\$6,426.3
FY92	\$7,894.8	\$6,753.0
FY93	\$7,675.9	\$8,454.8
TOTAL	\$42,633.4	\$27,935.1

A further erosion of the fund occurs because the statutorily-set interest rate on loans (8% simple interest since FY87) has, until this current year, resulted in a gap between the effective rate on loans and the true cost of capital. For a typical college student who borrows for four years, the effective rate over all of the loans is 5.8% because interest is waived while the student is in school. The following table displays the difference between the bond rates and the interest received on a four-year collegiate loan.

TABLE 2
Difference Between Cost of Capital to Program and to Borrower

School Year	True Interest Rate on Bonds	Effective Interest Rate on 4-Year Loan	Difference (Subsidy)
1988-89	8.4%	5.8%	-2.6%
1989-90	8.1%	5.8%	-2.3%
1990-91	7.3%	5.8%	-1.5%
1991-92	6.7%	5.8%	-0.9%
1992-93	6.0%	5.8%	-0.2%
1993-94	5.5%	5.8%	0.3%

At the present borrowing rate, effective interest just covers the cost of capital for the most recent bond sale; however, it does not allow the fund to recover any loan awarding and

servicing costs. In earlier days, administrative costs were supported by general fund appropriations. Since FY88, however, these program costs have been taken from program receipts--that is, from repayments on prior loans.

A recent legislative audit of the Alaska Student Loan Program¹ recognizes the changed fiscal situation of the program and the strains that earlier legislation and state policy have placed on maintaining fund viability. The report recommends that the loan fund be secured. The proposed legislation seeks to follow that recommendation by recognizing the true cost of capital, accounting for reasonable administrative expenses and increasing penalties for non-repayment of loans.

SECTIONAL ANALYSIS

Section 1 prohibits the Department of Commerce and Economic Development from renewing an occupational or professional license if the licensee is in default on an Alaska student loan. ACPE must notify the Department of defaulting borrowers. This section also provides for continuation of a license in the event that the borrower has a pending appeal of this action.

Rationale: Borrowers who have received state support for education or training leading to a occupational/professional license must honor their loan repayment obligations. The legislation allows the original license to be issued in order that the borrower may earn the income necessary to repay the loan. If repayment is not made in a consistent and timely manner, however, the borrower should not continue to benefit from the state's investment. It should also be noted that there currently are mechanisms in place such as unemployment deferment and hardship payment schedules to accommodate borrowers experiencing financial difficulties. This sanction is targeting those borrowers who fail to respond to any attempt to work with the Commission and must be transferred to collection agencies for more aggressive action on their defaulted account.

Section 2 ties the interest rate on a student loan to 1) the cost of the private capital backing that loan and 2) the administrative expense of disbursing and servicing the loan.

Rationale: The present interest rate of 8% bears no relationship to either the interest paid on bonds or the cost of running the loan program. today's capital market provides a very advantageous rate to tax-exempt bond issuers. Savings from low rates should benefit students. By the same token, in times of higher rates, the costs must be passed on to the borrowers if the fund is to remain sound.

Section 3 directs the Commission to notify the Department of Commerce and Economic Development when a borrower is in default.

Rationale: Since this department is charged with withholding license renewal, it is the Commission's responsibility to provide timely notification of default status.

¹ Division of Legislative Audit, *Alaska Student Loan Corporation Organizational and Operational Efficiency and Alternatives*, October 28, 1993 (Audit Control No. 05-4466-94). The findings were echoed by the Legislative Research Agency in *Privatizing the Alaska Student Loan Program*, a January 4, 1994 research report prepared at the request of Rep. Mark Hanley (Research Request 94.068).

Section 4 specifies that the Commission "ensures that the rate of interest is as low as possible without precluding" their ability to properly administer the loans and places a cap of 2.5% on that portion of the interest rate which is charged for administrative costs.

Rationale: This language provides incentive to loan administrators to operate loan servicing as efficiently and economically as possible by statutorily limiting the interest allowance available to cover loan origination and loan servicing expenses. This allowance does not cover losses to ASL funds due to forgiveness benefits and loan loss due to defaults.

Section 5 allows the Commission to consolidate a borrower's or a married couple's loans. Married borrowers must agree to be jointly and severally liable for repayment and the loan is not forgiven on the death of one of the borrowers.

Rationale: The existing loan portfolio is composed of varying conditions and interest rates, as shown in the following table.

TABLE 3
Difference Between Cost of Capital
to Program and to Borrower

Type of Loan	Percent of Portfolio
5% interest	27%
8% with no grace year interest	13%
8% with grace year interest	60%

Each loan is accounted for separately. Borrowers are often confused by the billing statement and by the apportionment of the monthly payment across the various loans. In some cases, a borrower may choose to pay off a higher interest loan more rapidly than a lower interest one. In order to split payment in such cases, staff must enter the payment manually. approximately one and three-quarters FTE staff Time is directed to manual posting of these payments each month. Because the loan consolidation will be eliminated. However, borrowers will be encouraged to take the option and a significant decrease in special payments is anticipated.

Section 6 excludes from eligibility any borrower who has had a previous loan written off by the Commission within the previous five years.

Rationale: Currently, a borrower can have a student loan written off if the borrower is certified as 50% or more permanently disabled by two doctors or if a loan has been discharged by a bankruptcy proceeding. Nothing in present statute prohibits a borrower from applying for and obtaining a new loan immediately. The proposed language would close this loop hole.

Section 7 allows the courts to assign to the Commission a portion of a defaulter's wages.

Rationale: Wage assignment is a powerful tool for enforcing loan repayment. In many cases, the threat of withholding wages is sufficient to encourage repayment. Where an assignment has been made, the loan fund benefits from at least partial payments. While wage garnishment can be done currently, this language would streamline the legal process by having the order included in the initial judgment by a court rather than having to request that by a separate action.

Section 8 applies the one-year residency requirement for Family Education Loans (FEL) to the borrower rather than the student.

Rationale: The Commission frequently encounters situations where a separated or divorced Alaskan resident parent wishes to borrow on behalf of a child for whom he/she does not have physical custody. In these cases, the parent with custody is often not a resident. The intent of the FEL program was to encourage parents to assist in funding a child's postsecondary education. FEL borrowers are generally very credit worthy and the default rate on these loans is only 4%. Therefore, it is in the best interests of the loan program to expand participation in this program to eligible Alaskans.

Section 9 deletes the requirement that an FEL can be made only on the behalf of a child who has been claimed as a dependent for federal tax purposes.

Rationale: Many potential FEL participants wish to borrow for children who are no longer claimed as dependents but who still need assistance in pursuing postsecondary education goals. Additionally, some parents object to sharing federal tax information with the loan program. The proposed changes would further encourage family responsibility and would provide relatively secure assets for the loan program without violating the financial privacy of the borrower.

CONCLUSION

The Commission supports CSHB 506(FIN) am because it provides the tools for fiscally-responsible management of the Alaska Student Loan program. Without the provisions of this bill, the fund will continue to erode. With it will erode the higher education opportunities for the coming generations of Alaskan students. Adoption of this bill will also strengthen our financial standing with New York bond firms such as AMBAC, Standard & Poors, and Moody's.

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To	Sen. Steve Rieger	From Steve Levinson
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April 17, 1994

Senator Steve Rieger, Chairman
 Senate HESS Committee. and members

Dear Senators:

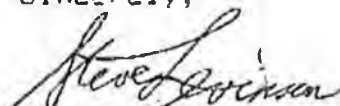
I want to offer very brief testimony in vigorous support of HB506 (Student Loan Reforms) as amended and passed by the House. My testimony is offered on behalf of the Alaska State Chamber of Commerce and the Dillingham Chamber of Commerce, both of which have adopted resolutions in support of this measure.

The key provisions contained in this bill that we support are the floating loan rate (keyed to cost of funds and administration), and the portions which attempt to tighten and clarify the student-borrower's obligation for timely repayment or conscientious effort to work with the ASLC for restructuring a payment schedule.

Viewing this bill as an effort to inject sound business practices into an important state program, both chambers give it their unqualified support and urge you to vote in favor so that it can move on to its final committee(s) and then go to the Senate floor for consideration and swift passage in the closing days of this session.

Thank you for taking the time to consider this testimony and thank you for your speedy deliberation of the bill.

Sincerely,



Steve Levinson
 Managing Director/USA
 and Director, ASCC and Dillingham CC