

HB

447

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

RECORDED
MAY 10 2002
SENATE FINANCE

DATE: 5/9/02

FURTHER:

DATE TURNED IN TO OFFICE: 10 May 2002

Finance Committee considered HOUSE BILL NO. 447

HB 447 COMMERCIAL FISHING & AGRICULTURE BANK INTEREST RATE

"An Act relating to the interest rates that may be charged on loans by the Commercial Fishing and Agriculture Bank."

and recommends:

- be replaced with _____ CS _____ (_____)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

Senate Bill:

- same title
- new title

House Bill:

- same title
- technical title
- new: SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
DCED	7/2/02		✓	#1

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	No REC	AMEND
<i>Lester Green</i>			—	
<i>Allen Curtis</i>	✓			
<i>James Huff</i>	4			
<i>Don Williams</i>	X			
<i>Sammy Wilber</i>			✓	
<i>Greg S. Leman</i>	✓			
COCHAIR: <i>[Signature]</i>			✓	
COCHAIR: <i>[Signature]</i>			✓	

MAY 10 2002

SENATE FINANCE
COMMITTEE

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: HB 447
(H) Publish Date: 4/4/02

Revision Date/Time (Note if correction):
Title Interest Rates on CFAB loans
Sponsor Representative Mulder
Requester House Labor & Commerce
Dept. Affected: DCED
BRU Banking Securities & Corporations (115)
Component Banking Securities & Corporations
Component No. 1233

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This legislation has no fiscal impact on the operations of this division.

Prepared by: Franklin T. Elder, Director Phone 907-465-2521
Division: Banking Securities & Corporations Date/Time 3/27/02 5:29 PM
Approved by: Deborah B. Sedwick, Commissioner Date 3/27/2002
Agency: Department of Community & Economic Development



REPRESENTATIVE ELDON MULDER

DISTRICT 23 - MULDOON & FORT RICHARDSON

ALASKA STATE LEGISLATURE

HOUSE OF REPRESENTATIVES

"PROUD TO BE A MULDOONER"



SPONSOR STATEMENT

HOUSE BILL 447

An Act relating to interest rates that may be charged on loans by the Commercial Fishing and Agriculture Bank

House Bill 447 addresses an inequity in Alaska Statute 45.45 that inhibits the ability of the Alaska Commercial Fishing and Agriculture Bank (CFAB) to serve it's mandated purpose of granting loans for Alaskan small business enterprises.

Like most states, Alaska has what is commonly called a "usury law"; a limitation on the rate of interest for certain types of loans – usually small loans. AS45.45.010 defines a small loan as one under \$25,000 and establishes a maximum annual fixed interest rate for such loans of 5.0 percent above the Twelfth Federal Reserve District discount rate.

In Alaska, conventional lending institutions - including commercial banks and credit unions – are allowed to select whether they use the interest rate identified in the federal law or the rate identified in state law by reason of Federal pre-emptive provisions. This approach is referred to as the "most favored lender" doctrine. Because of CFAB's organizational structure as a cooperative bank, it is the only Alaskan institutional lender subject to AS45.45 and by law, cannot charge "too much" interest. In reality, any interest collected in excess of its needs is credited back to its member-borrowers.

In the past, the commercial fishing community has not generated significant demands for small loans. However, because limited entry permits have recently begun trading in a \$20,000 - \$40,000 range, there is a much greater need for small loans. CFAB's subjectivity to the existing statute along with a period of the lowest financial market rates in over twenty years, renders it unable to make significant numbers of small loans to Alaskan residents, opening the potential for a drastic shift of permit ownership demographics.

The basic purpose of HB447 is to ensure that CFAB is able to continue serving its Alaskan member-borrowers in an efficient manner and equitably compete with other lending institutions servicing their unique market.

HB447 Talking Points

- An Act relating to interest rates that may be charged on loans by the Commercial Fishing and Agriculture Bank
- House Bill 447 addresses a problem in Alaska Statute 45.45 that inhibits the ability of the Alaska Commercial Fishing and Agriculture Bank (CFAB) to serve its mandated public purpose of granting loans for Alaskan small business enterprises.
- Like most states, Alaska has what is commonly called a "usury law"; a limitation on the rate of interest for certain types of loans – usually small loans. AS45.45.010 defines a small loan as one under \$25,000 and establishes a maximum annual fixed interest rate for such loans of 5.0 percent above the Twelfth Federal Reserve District discount rate.
- Three factors that brought the issue for CFAB to the surface and demanded a resolution:
 - Lowest Federal Reserve discount rate in recent history... 1¾% (existing statute allows a max of a fixed 6¾%)
 - Limited entry permit prices have recently begun trading in a \$20,000 - \$40,000 range, there is a much greater need for small loans (in the past CFAB rarely dealt in this loan market)
 - Recent Bank Examiner's Report highlighting the issue, warning that if the cap remains, it may lead to erosion of earnings for CFAB
- The basic purposes of HB447 is to ensure that CFAB is able to continue serving its Alaskan member-borrowers in an efficient manner and equitably compete with other lending institutions servicing their unique market.
- The fiscal note from the director of Banking Securities and Corporations states there is no fiscal impact to the state.

Background points:

- In Alaska, conventional lending institutions – including commercial banks and credit unions – are allowed to select whether they use the interest rate identified in federal statute or the rate identified in state law by reason of Federal pre-emptive provisions
- This approach is referred to as the “Most Favored Lender Doctrine”
- CFAB is not allowed to make that selection, because of its unique organizational structure established in Alaska statute
- CFAB is the only Alaskan institutional lender subject to AS45.45
- This change in statute levels the playing field
- Because of CFAB’s organizational structure as a cooperative bank, any interest collected in excess of its needs is credited back to its member-borrowers
- CFAB is the only private lender (vs. State’s Div of Investment) w/statutory authority to make a loan to purchase a LE permit *and* secure that loan with an enforceable lien on the permit itself
- CFAB’s subjectivity to the existing statute along with a period of the lowest financial market rates in over twenty years, renders it unable to make significant numbers of small loans to Alaskan residents, opening the potential for a drastic shift of permit ownership demographics
- Since CFAB’s funding costs, and most operating expenses, are variable, CFAB could not bear the risk of establishing a large volume of low-yielding, fixed rate loans in its portfolio
- Result of not changing the statute is that CFAB would have to choose to not make loans to small Alaskan businesses because it would adversely affect their profitability and thus the member-borrowers they serve

BANK EXAMINER'S REPORT

Management/Administration

99999

Management and the board of directors/trustees are evaluated against all factors necessary to operate the institution in a safe and sound manner and their ability to identify, measure, monitor, and control the risks of the institution's activities. Consideration is given to the level and quality of oversight and support provided by management and the board; compliance with regulations and statutes; ability to plan for and respond to risks that may arise from changing business conditions or initiation of new products or services; accuracy, timeliness, and effectiveness of management information and risk monitoring systems; adequacy of and compliance with internal policies and controls; adequacy of audit and internal control systems; responsiveness to recommendations from auditors and supervisory authorities; reasonableness of compensation policies and avoidance of self-dealing; demonstrated understanding and willingness to serve the legitimate banking needs of the community; management depth and succession; the extent that management is affected by or susceptible to dominant influence or concentration of authority; and the overall performance of the institution and its risk profile.

CFAB continues to be operated in a sound manner. During the last legislative session, management was successful in amending current law to gain new lending authority for activities related to tourism or natural resource extraction. Since the passage of this legislation, management has originated seven loans totaling \$2,905M. Management intends to enter these new lending markets cautiously, in order to judge the effectiveness of all guidelines and policies that either have been or are in the process of being developed.

Over the next year, CFAB will undergo a substantial management change with the anticipated retirement of two essential personnel. The chief lender is retiring from the institution after almost 18 years with the institution. The president is also planning to retire after more than 17 years with the institution. These two individuals were primarily responsible for rebuilding CFAB during the mid-80's recession. It will be a significant event for the institution to find eligible candidates as replacements, but even more significant is the loss in institutional knowledge. Prior to his retirement, the president would like to resolve important issues that are obstacles to CFAB's continued operation. One of the issues relates to the state usury law under AS 45.45.010, which subjects CFAB to an interest rate cap. Because of deterioration in the fishing industry, CFAB has experienced a decrease in loan amounts, to the point where they may fall under \$25,000. Because the usury law limits the interest rate to five percentage points above the 12th Federal Reserve discount rate on loan amounts of \$25M or less, CFAB may find itself subject to this limitation. If the cap remains, it may lead to erosion of earnings for CFAB.

The board has also changed since the last examination. Two new members, Dan Farren and Susan Springer, were elected during the last annual meeting. The board minutes indicate the board members are active in a wide range of issues that affect the institution's operation.


New policies have been adopted since the last examination. These policies address appointment of management during emergencies, fixed asset expenditures, and a CoBank borrowing resolution. Insurance and bond coverage appear satisfactory.



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(907) 276-2007 Fax (907) 279-7913

May 2, 2002

Edward E. Crane
President

TO: Senate Resources Committee
FROM: Ed Crane 
SUBJ: HB 447

For ease of reference, we call HB 447 a "CFAB bill," and I have testified that "CFAB wants it." But in reality CFAB is simply the aggregation of the interests of its present and future owners who comprise the limited segment of the public it was created and mandated to serve.

Through its statute (at AS 44.81.041) CFAB is mandated by the legislature to be, and to operate as, a cooperative. Every borrower becomes an investor and owner of CFAB. And any and every benefit or advantage that results from CFAB operations is a benefit or advantage to those owners – not to anyone else. We are all paid salaries at CFAB – there are no bonus plans, no stock options, no profit-sharing!

Federal tax law for cooperatives requires CFAB to treat each borrower-owner alike with respect to the annual allocations of its margins (the cooperative term for "profits"). Within the constraints of AS 45.45.010(b) CFAB cannot do that for small loans without forcing subsidization by all other borrower-owners, since those small loans do not produce margins.

In the final analysis, the message of HB 447 is, "Here's a piece of CFAB's public purpose it has been unable, and remains unable, to serve. It hasn't mattered much in the past, but today's circumstances are such that it's likely to be a much more meaningful void. CFAB can fill that void if HB 447 becomes law."

Like most states, Alaska has what is commonly called a "usury law"; a limitation on the rate of interest for certain types of loans – usually small loans. Alaska Statute 45.45.010 defines a small loan as one under \$25,000 and establishes a maximum annual fixed interest rate for such loans of 5.0 percent above the Twelfth Federal Reserve District discount rate (currently 1.75 percent).

"Usury" is a term whose meanings and connotations have changed over the years. There are a number of Biblical references, generally favorable, to usury. Over the ensuing thousands of years, though, societies and governments have determined and decreed that the term refers to interest rates which are unrealistic, unconscionable, or unlawful. Webster's New World Dictionary (Second College Edition) recognizes this change of meaning by defining the word as, "the act or practice of lending money at interest, now specifically, at a rate of interest that is excessive or unlawfully high."

The philosophies underlying usury laws are protective in nature. The Alaska Supreme Court, in a 1971 case, expressed that usury laws are designed to protect the necessitous borrower. They recognize that those whose needs and means are modest may often have the least flexibility, the fewest alternative sources of credit, and the fewest tools with which to bargain. The callous – but basically realistic – expression, "The poor pay more!" perhaps has no clearer application than may be found in the loan-sharking practices visited upon blue-collar communities, and even small businesses, in many parts of the United States. It is difficult to find arguments against these intents and philosophies; on the other hand, one may question the effects of the arbitrary manner in which the limits are set.

In Alaska, conventional lending institutions are not actually subject to the usury statute. A company whose principal business is the granting of small loans may organize under the Alaska Small Loans Act (AS 06.20), which effectively substitutes other, more liberal, interest rate limitations for that established by the usury statute. A few years ago, there were 18 to 20 such companies in Alaska; today there are apparently almost none. The vast majority of lending institutions – including commercial banks and credit unions – are effectively exempt from state usury statutes by reason of the pre-emptive provisions of Federal laws and regulations. There are a handful of other lenders, primarily private mortgage companies, who do not make loans under \$25,000 as a matter of policy and who

therefore are not affected by the usury statute. Of the two lenders who operate directly and primarily within CFAB's mandated market, one - Northwest Farm Credit Services - is subject to Federal laws which preempt Alaska's usury statute, while the other - the state's own Division of Investments - appears to enjoy a sovereignty exemption. Even those storefront enterprises that offer check-cashing services and "payday loans" to a clientele consisting largely of "necessitous borrowers" are beyond the reach of AS 45.45.010!

It appears that CFAB is the only corporate or institutional lender which is subject to Alaska's usury statute. Paradoxically, CFAB is also the only lender in Alaska which, by definition, cannot charge or collect "too much" interest!

CFAB is structured as, and operates as, a cooperative corporation as mandated by its governing statute. Its owners are its customers, and its customers are its owners; these customer-owners are known as "members." The interest rates charged to members are based on projections of CFAB's own borrowing costs and operating expenses. At the end of each fiscal year, excess income ("net margins," in cooperative parlance) is returned to members through a mechanism called a patronage refund. Over the past ten years, CFAB has returned over 16% of its gross interest income to members in this manner and has added another 2% of that gross income to the equity pool owned by the aggregate membership. Effectively, every borrowing member - large or small - is dealt with by CFAB on an "at cost" basis regardless of the interest rate paid.

Until very recently, CFAB's unique subjectivity to AS 45.45.010 has been viewed as a minor annoyance. The capital requirements of commercial fishing, as a generality, have not generated significant demands for small loans. As a rule - although absence of a firm policy permitted exceptions on a case-by-case basis - CFAB has discouraged small loans except to established members. Even those latter loans were limited to relatively short terms. Since CFAB's funding costs, and some operating expenses, are variable, CFAB could not bear the risk of establishing a large volume of low-yielding, fixed rate, loans in its portfolio with the potential for subsidization by other borrowing members during periods of higher or increasing interest rates or other costs. In addition, many of the origination and administration costs are essentially the same for a \$20,000 loan as for a \$120,000 loan.

At the present time, however, a convergence of factors has created a difficult scenario for CFAB and potential new members and, more importantly, a very real threat to the public purpose established for CFAB by the Alaska Legislature.

CFAB is the only private lender with the statutory authority to make a loan to purchase a limited entry permit and to secure that loan with an enforceable lien on the permit itself. Since CFAB serves only Alaska residents, this authority has proven a significant boon to those residents wishing to enter a fishery. On the other hand, when permits for many fisheries commanded transaction prices of \$150,000 to \$200,000 or so (a not uncommon range) a non-resident wishing to purchase a permit needed to possess some combination of cash and other lienable assets equal to or in excess of the purchase price in order to secure financing from some lender other than CFAB. This has been a significant, but probably incalculable, factor in maintaining a high level of resident participation in Alaska's fisheries.

In recent years, however, many fisheries' economics have changed. Today limited entry permits in some of Alaska's largest fisheries (in terms of participant numbers) are trading in a \$25,000-\$40,000 range. It has suddenly become much more feasible for the legendary "Seattle dentist" to simply obtain a low-cost home equity loan in order to buy an Alaska limited entry permit. Moreover, an increasing number of those residents who received "original issue" limited entry permits are reaching retirement age and seeking the opportunity to exit their respective fisheries. Several Seattle-based permit brokers, whose interests lie in facilitating transactions rather than in supporting public policy, have indicated an awareness of these factors. The immediate future appears to hold the potential for a drastic shift of permit ownership demographics!

At the same time, CFAB is effectively immobilized by a trio of irreconcilable factors: (1) A period of the lowest financial market rates -- specifically, the discount rate of the Federal Reserve Bank of San Francisco -- in its 21-year history; (2) Its subjectivity to AS 45.45.010; and (3) Its fiduciary duty to existing member-owners.

This is most certainly not a matter of intent by any party. Much legislative energy has been focused on CFAB over the years, not only through the originating efforts of

the 1978, 1979, and 1980 Legislatures, but in the many ensuing actions to address the unexpected or unintended anomalies which are probably inherent to the creation and existence of a truly one-of-a-kind instrument of public policy. While this appears to be one of the most threatening such anomalies to manifest itself, it is also probably one of the easiest to correct!

SENATE COMMITTEE REPORT

DATE: 4/9/02

FURTHER: Finance

DATE TURNED IN TO OFFICE: 5/2/02

Resources Committee considered **HOUSE BILL NO. 447**

HB 447 COMMERCIAL FISHING & AGRICULTURE BANK INTEREST RATE

"An Act relating to the interest rates that may be charged on loans by the Commercial Fishing and Agriculture Bank."

and recommends:

- be replaced with _____ CS _____ (_____)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

Senate Bill:

- same title
- new title

House Bill:

- same title
- technical title
- new: SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
DCED	3/27/02		✓	1

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	Do PASS	Do NOT PASS	No REC	AMEND
<i>Adrian I. Taylor</i>	✓			
<i>Ben Jones</i>				
<i>Greg White</i>				
CHAIR: <i>Adrian I. Taylor</i>				

SB 55 Sign-In

NAME: Gene Daw Subject/Bill No: 55
Co./Dept./Title: Legislative Dir Post 559 Phone: 586-3814
Address: 6420 20995 Juncu VFW Zip: 99802
Do you wish to testify? Yes No Respond To Questions

NAME: GARY BERRY Subject/Bill No: 55
Co./Dept./Title: American Legion Phone: 463-2662
Address: 9050 N Douglas Hwy Zip: 99801
Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____
Co./Dept./Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____
Co./Dept./Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____
Co./Dept./Title: _____ Phone: _____
Address: _____ Zip: _____
Do you wish to testify? Yes No Respond To Questions