

MINUTES

**MONTANA SENATE
53rd LEGISLATURE - REGULAR SESSION**

COMMITTEE ON EDUCATION

Call to Order: By Senator Blaylock, on March 5, 1993, at 3 p.m.

ROLL CALL

Members Present:

Sen. Chet Blaylock, Chair (D)
Sen. Harry Fritz, Vice Chair (D)
Sen. John Brenden (R)
Sen. Bob Brown (R)
Sen. John Hertel (R)
Sen. Spook Stang (D)
Sen. Daryl Toews (R)
Sen. Mignon Waterman (D)
Sen. Bill Wilson (D)
Sen. Bill Yellowtail (D)

Members Excused: None

Members Absent: None

Staff Present: Eddye McClure, Legislative Council
Sylvia Kinsey, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing: HB 293
HB 324
HB 384

Executive Action: HB 276
HB 293

HEARING ON HOUSE BILL 293

Opening Statement by Sponsor:

Representative Bea McCarthy, House District 66, Anaconda, said she had introduced HB 293 at the request of the Commissioner of Higher Education and would eliminate the requirement that the Board of Regents contract only with a nonprofit organization to administer the loans that are granted under the guaranteed

student loan program. She explained the problems which arose in trying to find a nonprofit organization.

Proponents' Testimony:

Bill Lannan, Director, Montana Guaranteed Student Loan Program spoke as a proponent of HB 293 and explained the bill. A copy of his testimony is attached to the minutes. (exhibit 1)

Opponents' Testimony:

None.

Informational Testimony:

None.

Questions From Committee Members and Responses:

Chair Blaylock asked Mr. Lannan if this was only that one small change which would let them go to the "for profit" corporations. Mr. Lannan answered yes, that was correct.

Closing by Sponsor:

Senator McCarthy said Senator Stang had asked why they went nonprofit in the beginning and said they were required to do so by the law. There were only two in the United States that submitted proposals. They believe in the ensuing years the market has opened up and they will be able to get a better bid and be able to save the students money by going to a profit group.

HEARING ON HOUSE BILL 324

Opening Statement by Sponsor:

Representative Jay Stovall, House District 98, Billings, said this bill is a constitutional amendment which would amend Article 10, Section 12. He said approximately a year ago the Board of Education brought a lawsuit against the Montana Administrative Code and because of the decision of the law suit, at the present time the Board of Education does not have to go through the Legislature to get funded and have their actions approved. He said it started over the Gifted and Talented Program which the Board wanted and the Legislature decided they could not afford it. He felt expenditure of funded funds should go through the Legislature.

Proponents' Testimony:

None.

Opponents' Testimony:

Wayne Buchanan, Board of Public Education, said this goes further than other measures of this kind that have been proposed statutorily. He said this bill would eliminate the Board's function of accreditation. The Legislature would have to hear and approve the accreditation standards and provide or not provide the funding for them.

Eric Feaver, Montana Education Association said the MEA is opposed to this idea and similar ones throughout the last decade and they find this bill very dangerous. He referred the committee to page 2, (3) (a) where the law states there is a Board of Education to exercise general supervision over the public school system and such other public educational institutions as may be assigned by law. There is statute on how the Board will provide this supervisory authority. On page 3 he read the proposed constitutional changes and said he felt it would in reality, eliminate the Board of Education's accreditation function. He believed it would go further and eliminate the Board of Education in every respect, and in effect, the Legislature would become the Board of Education.

John Malee, Montana Federation of Teachers said he would concur in the testimony given by Mr. Feaver, and urged the committee give a do not pass to this bill.

Informational Testimony:

None.

Questions From Committee Members and Responses:

Senator Waterman told Mr. Buchanan that it seemed to her there was sort of a healthy friction that was created in the Constitution and that the Board had supervisory control. The Board was to set the standards to tell Montanans what they believe a quality educational system ought to be and set the standards that would meet the needs of the students. The Legislature's responsibility is funds. She believed this was a balance because if the Board set standards the state could not afford, then the public is the one who either pressures the Board to lower the standards or pressures the Legislature to increase the funding and, as a populous state, that is what the framers of the Constitution meant. She asked if Mr. Buchanan saw it that way, or if she was wrong in her perception of how this process works. Mr. Buchanan said he believed that was an accurate representation. The only thing he would add was that the board should necessarily define a quality education, and there was argument as to whether the Board or the Legislature should do that.

Senator Toews said we talk about funding education and in this committee we talk about funding at 80% of what it costs to run a

school. He believed the way this bill reads that it must be funded at 100% of the cost to run a school. He asked if he was correct in that analysis. Representative Stovall said it might be stated that way in the bill, but that was not their intent. He said it was not their intent to eliminate the Board of Education, simply that they must come to the Legislature to get funded. Representative Stovall said it might be read that way but he believed the intent was to fund it as we have in the past.

Senator Toews referred to page 3 and said the language seemed to imply that unless the Boards actions are approved and funded by the Legislature, it would be 100% funded.

Chair Blaylock directed a question to Mr. Feaver where he had said in effect, the only place the Legislature had "stuck it's nose in", is in the area of Gifted and Talented and asked if that was correct. Mr. Feaver said yes, in the curriculum arena. Chair Blaylock asked about American History and said he thought the Legislature had required that. Mr. Feaver said he was unaware of there being any course descriptions in the statutes. Gifted and Talented was an exception, and that did not come in because the Legislature was being intrusive, but because some folks 15 years ago thought the way to make it happen was to legislate it. He said it did not work with the Board of Education so they placed in the permissive statute that allows school districts to have Gifted and Talented programs, should they desire to do so. This gave rise to the Board of Public Education which three times has adopted various standards regarding GFT, two of which were pretty directive in terms of programs and now one that is not so directive at all. The conflict between the Board of Education demanding the GFT, no matter how "weak" it might be, is what led to the Judicial decision of Judge Sherlock last spring.

Chair Blaylock said he was in favor of a GFT program and would have said yes, he approved of what the Board of Education did. The Legislature said no and that went to Court. At the district Court level, the ruling was that the Board did have the right to say that, and Chair Blaylock said he had disagreed with the court ruling. He believed the Legislature did have the right to say no, even though he liked what they had done.

Mr. Feaver said that Court decision was not appealed to the Supreme Court, a lot of people thought it would be and perhaps should have been. The principle that the Legislature could have addressed itself to the GFT, and some have predicated it upon already being in the statutes, is not exactly an open invitation for the Legislature to, in effect, shackle the Board of Education in everything it would purport to do. In this proposed Constitutional Amendment, it is a statement that the Board may not act in a manner that obligates the expenditure of public funds unless approved by the Legislature. He said he did not know how the Board could turn on the lights in the morning without Legislative approval. This bill could well lead the

Legislature back into Court and it could wind up at the Supreme Court level looking for the kind of decision you think would be appropriate to resolve this issue.

Closing by Sponsor:

Representative Stovall closed by saying he did not believe this bill would eliminate the Board of Education, but perhaps it might, more or less, keep them in their place.

EXECUTIVE ACTION ON HOUSE BILL 293

Motion/Vote: Senator Fritz moved House Bill 293 BE CONCURRED IN. The motion PASSED unanimously with those present, Senator Yellowtail was absent. Senator Brown will carry the bill.

HEARING ON HOUSE BILL 384

Opening Statement by Sponsor:

Representative Richard Simpkins, House District 39, Great Falls, said this bill does three things. It completes the law, it takes into consideration the recent Court case involving the State Board of Education and the actions of the Legislature when we passed HB 312 which cancelled the rule from the State Board of Public Education. The third part gives the school districts more local control in the funding process. He went through the bill and explained how these three things were addressed. He said he was a little concerned about the fiscal note because on item 2, the impact could be either an increase or a decrease, but he did not believe the figures were correct.

Proponents' Testimony:

Don Waldron, Montana Rural Education Association, said the Association believes the Board of Education, over the years, has had some problems of forcing things down school's throats when they could not afford to do it. They have had some excellent luck in recent years in working with the State Board and seeing that this did not happen, and they have given reprieves in ways that have increased their resources so they could stretch their budgets. Over the years this might be a good bill to have passed, he would endorse the bill, but has a few reservations about it.

Opponents' Testimony:

Wayne Buchanan, Board of Public Education, said this bill is really a combination of two bills that were in the House, the first HB 248 and the second 384. The bill says the Board may not adopt rules or policies until the Legislature specifically acts to fund the rules, and this causes a problem. The second part of

the bill provides that if they do adopt rules, the school district cannot be forced to comply with the rules by having funds withheld. He pointed out that if this should become a statute, we would have a statute that goes in two directions. The first part of this bill confronts the Sherlock decision which said the Board has a constitutional power to adopt rules. The Legislature also gives the Board, in certain instances, the power to adopt rules and if it is the intent of the Legislature to confront the Sherlock decision, this might be a good vehicle to do so. At the present time, the clear language on the face of the Sherlock decision is that this would be unconstitutional. He said the second part may not be unconstitutional because the "power of the purse" has long been in the hands of the Legislature.

Eric Feaver, MEA, said the language on page 2 largely restores what Senator Smith wanted to do in his bill. This bill would involve the Legislature in making standards. He suggested that if this bill were passed out of committee, he would recommend (4) be deleted from the bill before it was accepted.

John Malee, Montana Federation of Teachers, said he would like to go on record as being opposed to this bill.

Informational Testimony:

None.

Questions From Committee Members and Responses:

Senator Waterman said Mr. Waldron had mentioned problems created in the past for school districts, and asked him if there were school districts that had their funding withheld and was told not to his knowledge. He did not believe anyone had ever withheld the ANB funding. Senator Waterman said the only school district she could remember being seriously threatened was Lewistown when they couldn't pass a bond issue for a building. She asked if Mr. Waldron could think of another situation where, based on accreditation standards, they were seriously threatened. Mr. Waldron said he believed there were some small schools threatened, but never taken to the last step. Senator Blaylock said he was not positive, but believed when Mary Condon was the State Superintendent of Public Instruction (she took office in 1949), there were school districts not complying with something. It involved schools like Rudyard, Gilford, Hingham and Kremlin and she said "you are not getting state funds". The Foundation Program went into law in 1949 and they more or less ignored the ultimatum. In those years the wheat crops were so good that they ran their schools anyhow. That was the only time he knew of where funds were withheld.

Mr. Waldron said he believed they would get down to the last warning and every newspaper in the area would pick up the warnings and they would find some way to survive.

Senator Brown asked if this had come in as a response to the Sherlock decision on GFT and Representative Simpkins said there is a tremendous amount of misinformation passed out, and the Sherlock decision is one of them. Yes, this bill is a result of the Sherlock decision to clarify this law, and in looking at the statute as it exists on the books at the present time, it is incomplete.

Senator Brown said when the bill was introduced and the statute amended, it seemed to him there were two different concepts in it. Mr. Buchanan challenged the constitutionality and asked if this would be a companion of Representative Stovall's bill. Representative Simpkins said no, this bill has nothing to do with Representative Stovall's bill.

Senator Brown asked Representative Simpkins to comment on Mr. Buchanan's comments in regard to the constitutionality. Mr. Simpkins said there are two interpretations of the Sherlock decision. Sherlock's decision refused to go back into the Constitution and say this is what the Constitution says and you have rule making authority. By that definition it says we cannot use our administrative rules authority, which is the way we cancel a rule from a department because if they don't cancel a law at our request, we pass a law and say it is cancelled. With their constitutional authority to publish their own rules, we cannot use that procedure to cancel their rules. The unquestioned and unchallenged portion of the Sherlock decision, "can the State Board of Public Education adopt a rule that is contrary to law", was not ruled on by Sherlock, it was not even looked into. If that is true, then we have a fourth branch of government and oligarchy that the Board has which nobody has any control over. Neither the Legislature nor the Governor has any control over them, and it is the only branch of government that is sitting out there by themselves and can do their own thing with no controls.

Senator Brown said he believed the Judge in the Sherlock case ruled that because this supervisory control language is in the constitution, it governs or supersedes any statute the Legislature could pass. He believed that inherent in our government, the Legislative branch of government is the policy making branch, and his view was that the Sherlock decision was a "haywire" decision that probably would not have been upheld in the Supreme Court. He believed it was unfortunate that it was not appealed.

Representative Simpkins said he believed if you took the Sherlock decision in it's narrow interpretation of saying they have constitutional authority to publish their rules regardless of the Legislature and the Legislature cannot cancel the rules with the Legislative process, the Supreme Court would have to rule that is correct and we would really have a problem because the one critical question is not answered. He said that question is whether the State Board of Education can publish a rule that is

contrary to law, and until that is answered we have this problem.

Senator Waterman said there is another view that the Constitution says the Board has supervisory control and therefore we cannot pass a law that intercedes into their supervisory control. They have constitutional authority, we don't have to fund it, and that is where "the rubber meets the road". If we don't fund it, the people will decide which way to go. She asked if we have the power to intercede into their constitutional authority.

Representative Simpkins said he believed Judge Sherlock used the West Virginia Supreme Court ruling to determine what the constitution of Montana said. One thing that stands out in the entire constitution is that those people in the con-con wanted local control, and not to be controlled by the Board. They stood on the floor and inserted the word "basic" because they wanted people to know it was basic. We have removed the word "control" from the State Board of Education because we want to emphasize that the power rests with the local boards of trustees.

Senator Waterman, addressing Representative Simpkins, asked if he would then say that local boards, because of their control, should be able to ignore the accreditation standards that are passed under general supervision of the Board of Education if they would choose not to teach English or Math. Representative Simpkins said that came up under another statement. Testimony here today said no local control, and if this rule is implemented and the local boards do not have the money, tough luck, you do it or we will hold back your money--that is the law. He did not believe a school district was retroactive in this case. It only deals with the future and has nothing to do with English or Math courses; it is not retroactive.

Senator Brenden asked Mr. Feaver if he would say that perhaps using two years of science and four years of English is a poor example of what they could do if they cut programs. Mr. Feaver said it is an example and he had used it because in the lobbying business we try to get your attention. If you look at the section of the law he had referred to it raises a serious question. Looking at the language by itself, he was not sure Representative Simpkins was correct in saying this would not be retroactive.

Chair Blaylock referred to page 2 of the bill, lines 18 through 20 and asked if that isn't a pretty good definition of impact and Representative Simpkins said he believed that was enough of a definition.

Senator Blaylock asked Representative Simpkins about his statement that he didn't feel that local school boards could, in effect, go back and undo some of the things that are in effect now. If we say the State Board of Education has no authority, wouldn't they be able to do that and just say "we are not going to go by any of the rules that are laid down by the State Board of Education, we will do as we please". Representative Simpkins

said this was his interpretation when they drafted the legislation and he asked a question concerning retroactive, he believed there would have to be a statement in the bill that said the rule is retroactive, otherwise it is effective the date. It was his belief that any rule that has been adopted by the Board of Education is not affected by this law.

Ms. McClure said they do not imply anything is retroactive, there must be a statement within the bill, the legal language, that makes it retroactive.

Chair Blaylock said if we were to adopt this bill and make it the law of the state of Montana, if a local school board did not like some of the new standards that were put in since project excellence, and said they would not abide by them, they would have the power to say "we are not going to abide".

Representative Simpkins said no, those rules have already been adopted by the State Board of Education and they would have to say this law will be retroactive. Chair Blaylock was still concerned that if we say all power lies with the local board, and if that would be the result of the adoption of this law, then he could not see that where there would be any restrictions on what a local board wanted to do. The bill says we cannot withhold money, and if some of the rules are not wanted or too expensive for the local boards, then he did not see anything to stop them from saying it is out. Representative Simpkins said he was only going by the Legal Counsel. Ms. McClure said they do not make anything retroactive unless the bill specifically states so.

Senator Waterman said going back to what Mr. Feaver said, she understood in reading the bottom of page 2 and the remainder of page 3, it says no funds withheld etc. Then it seems to separate it into two categories and if you read it as Mr. Feaver did, "a school district may not have state funds withheld if a board rule policy or standard, having substantial financial impact on a school district is not funded by a school district". That doesn't seem to say any rule under this section or adopted in the future, it says "any rule or policy", and therefore she could not understand why it couldn't be an existing policy. Ms. McClure said because it doesn't say "previous rules". Any bill we do in the Legislature, any bill where they put an amendment in, that amendment has to take effect on a certain date. The old rule does not take effect until that date and it is futuristic. In order to make anything retroactive, it has to have the statement making it so. You cannot imply you are going backwards, it has to be stated.

Chair Blaylock said he could accept this, but if that local board digs in it's heels and says "we are not going to do this any longer", then what do we do about it since the Board of Education or the State Superintendent cannot withhold any funds. He could not see where anybody could do anything and the local board would rule.

Representative Simpkins asked if we just go under the provisions of this section and scratch out the rest, would it be a satisfactory bill. We are basically saying that the State Board of Education must follow these rules. He was referring to page 3, line 3, "the provisions of this section, period". All he was interested in was how we put in rules that will have a significant financial impact on the schools so we can determine if they really need the money, or what the situation is. Chair Blaylock said they would look at this and would look the bill over and see if it could be made workable.

Closing by Sponsor:

Representative Simpkins said he was concerned over what he had heard today. As members of the Legislature you have just been told you have no authority over these schools, nor over the school board.

EXECUTIVE ACTION ON HOUSE BILL 276

Discussion: Senator Toews said he had some problems with this bill. In these small districts when you have few board members, there are many times that the board meetings are called intentionally when certain people are on vacation. When you hire someone and it is nepotism, many times it is deliberate. Senator Brown said the bill is built around who is present at the meeting.

Senator Fritz said it seemed to be a reasonable way of handling a situation where the previous law insisted everybody be there and some school boards went weeks or months unable to transfer any business because one person was absent.

Discussion was expressed that there might be a bigger problem of nepotism if this bill were passed.

Motion/Vote: Senator Brown moved House Bill 276 BE TABLED. Motion PASSED with Senator Fritz and Yellowtail voting no.

ADJOURNMENT

Adjournment: 4:28 p.m.


CHET BLAYLOCK, Chair


SYLVIA KINSEY, Secretary

CB/sk

ROLL CALL

SENATE COMMITTEE EDUCATION

DATE 3-5-93

[illegible]

SENATE STANDING COMMITTEE REPORT

Page 1 of 1
March 8, 1993

MR. PRESIDENT:

We, your committee on Education and Cultural Resources having had under consideration House Bill No. 293 (first reading copy -- blue), respectfully report that House Bill No. 293 be concurred in.

Signed: Chet Blaylock
Senator Chet Blaylock, Chair

M - Amd. Coord.
 Sec. of Senate

Senator Brown
Senator Carrying Bill

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STATE EDUCATION

EXHIBIT NO. 1

DATE 3/5/93

BILL NO. 293

History
of the
Montana Guaranteed Student Loan Program
by
Bill Lannan, Director

January 1993

The purpose of this report is to provide a background to the reader on the Montana Guaranteed Student Loan (GSL) Program. In addition to this basic description of the program, the reader is directed to the U.S. Codes Title IV of the Higher Education Act Part B and the current regulation 34 CFR 668 and 34 CFR Parts 682 and 683.

Federal legislation was enacted by Congress in 1965. Most, if not all federal student aid programs are contained in Title IV of the Higher Education Act of 1965. Subsequent amendments to the act have been made by almost every Congress since. After Congress authorized the fifty states to establish state guarantee agencies, the 1979 Montana legislature adopted the laws included in Title 20, Chapter 26, Part 11, MCA. The Board of Regents of Higher Education was delegated the authority to establish the program and provide for the guarantee of loans and the administration of the program. Hereinafter, the term "agency" or "guarantee agency" shall mean the Board of Regents of Higher Education.

A number of entities or institutions play a role in the student loan program. They are, first of all, the Board of Regents or guarantee agency. Second, the private lending community who provides the capital and makes the student loan. In Montana there are about 100 lenders representing banks, savings and loan associations and credit unions. Third, the postsecondary educational institutions throughout this nation enroll the students who may be eligible for student loans. A very important partner in the Guaranteed Student Loan Program is the secondary market. Almost all Montana lenders sell their loans to Montana Higher Education Student Assistance Corporation (MHESAC). The secondary market provides liquidity to the originators of student loans, i.e., banks, savings and loans, and credit unions. MHESAC portfolios include 90% of all Montana Guaranteed Student Loans in repayment. In order for a school to be eligible, it is required to request participation from the U.S. Department of Education and satisfy the educational, administrative and fiscal requirements of the Department. Finally, there are the students who borrow money from the lender to pay educational expenses to attend postsecondary institutions. Because the student borrower normally has no assets or collateral, the guarantee agency provides a "guarantee" to the lender. If the student defaults, the agency will pay the lender the outstanding principal and interest.

A brief scenario would be, a student enrolls in an educational institution and needs additional resources. The student's intent is to borrow money from his/her local banker to pay some of the educational costs. If the student

believes he/she is eligible to borrow under federal subsidized and/or unsubsidized Stafford Loan (formerly GSL) program, the student completes a financial needs analysis form and loan application. An independent servicer processes the financial needs analysis form and submits the results to the educational institution. The educational institution reviews the needs analysis and determines if the student is eligible to borrow. Eligibility depends on the student's and/or parents' financial resources; the cost of education (tuition, fees, board and room, books, travel, miscellaneous living expenses, etc.); and any other assistance or financial aid the student will receive. Effective July 1, 1993, a first year student can borrow up to \$2,625 per academic year, second year students can borrow \$3,500 per academic year. Upper division undergraduates or third and fourth year students can borrow up to \$5,000 per academic year. Effective October 1, 1993, graduate and professional students can borrow up to \$8,500 per academic year. There are also aggregate limits for undergraduate and graduate student borrowers. An undergraduate student may borrow an aggregate of \$23,000 and a graduate or professional student may borrow \$65,500 in aggregate, including the undergraduate loan. After the school determines student eligibility and the maximum amount a student may borrow, the student takes the application to a participating lender who agrees to loan the money. The lender then sends the application to the guarantee agency for processing.

In processing the borrower's application the guarantee agency determines whether the borrower is eligible, i.e. no outstanding defaulted loans, the educational institution is a participating school, and the lender is an eligible lender. If all eligibility criteria are met, the guarantee agency issues the lender a "notice of guarantee" which insures the lender against loss of outstanding principal and interest in the case of a prospective default. Upon receipt of the notice of guarantee, the lender can send the student a check for the amount of the loan. The loan check is normally mailed to the educational institution in multiple disbursements over the academic year to be delivered to the student. The student is obligated to use the funds for educational purposes only. As long as the borrower is in school and qualified for a subsidized loan, the Department of Education pays interest accruing on the student loan. Upon graduation or when the student borrower officially withdraws from school, the loan enters a grace period six months after which the borrower begins making payments of principal and interest. The interest is 7, 8 or 9 percent or a variable rate, depending on the date the borrower first borrowed. Borrowers taking out their first Stafford loans after October 1, 1992, pay a variable interest rate.

If the student was not eligible for a subsidized Stafford loan the student may have qualified for the unsubsidized Stafford loan. In that case, the student, not the Department of Education, pays the interest that accrues while the student is in school.

In addition to the Stafford loan, an independent borrower can borrow under the Federal Supplemental Loans for Students (SLS), or the parent of a dependent student can borrow under the Federal Parental Loans for Undergraduate Students (PLUS). Neither of these programs provide interest subsidy while the student is in school and the loan enters repayment 60 days after disbursement. SLS and PLUS borrowers are entitled to deferment of principal while the student is in school but the interest accruing during this time must be paid or capitalized.

A more detailed discussion on how the guarantee agency operates follows. An obvious question would be how does the guarantee agency get the funds to

administer the student loan program and pay the lenders for defaulted loan claims. Under section 20-26-1106 MCA the state is not obligated to appropriate any money to pay student loan defaults nor can the guarantee agency obligate the credit of the state. Other sources of funds must be available. Section 20-26-1105 MCA establishes a guaranteed student loan account into which all money designated for the guaranteed student loan program is credited. There are seven sources of funds:

- 1) The insurance fee, or guarantee fee, charged to each borrower on a Federal Stafford, SLS or PLUS loan. The fee is 3% of the principal amount of the loan.
- 2) An administrative cost allowance (ACA) the Department of Education pays the guarantee agency for administration of the program. That allowance constitutes 1% of the loans guaranteed by the agency and is paid on a quarterly basis.
- 3) The supplemental pre-claims unit is reimbursed \$50 from the Department of Education on each loan satisfactorily brought current providing that the loan is at least 120 days delinquent, before the delinquency is resolved.
- 4) Interest earned on the investment of funds not necessary for the program operations. These funds are invested by the State Board of Investments.
- 5) Reinsurance claims paid to the agency by the Department of Education to reimburse the agency for purchasing defaulted student loan claims from lenders. The agency and the Department of Education have entered into an agreement whereby the Secretary of Education agrees to reimburse the guarantee agency for losses resulting from the death, bankruptcy, or total and permanent disability of a borrower. Losses resulting from the default of borrowers are reimbursed at 100%, 90% or 80%, depending on the annual default rate characteristic of the guarantee agency. If the guarantee agency's annual default rate is 5% or less, the reimbursement is 100%; less than 9% and more than 5% the reimbursement is 90%; greater than 9% the reimbursement is 80%.
- 6) Recoveries from defaulted borrowers. The guarantee agency is obligated to collect principal and interest from defaulted borrowers. Through the efforts of the guarantee agency's collection practices or through the utilization of collection agencies, recoveries are received from student loan defaulters. Normally, the guarantee agency is entitled to keep 30% of the money recovered through collections to help pay collection costs; it returns 70% of the recoveries to the Department of Education. In addition, federal and state income tax offsets are also used on defaulted borrowers, as well as wage garnishments.
- 7) Initially, federal advances were made to the guarantee agency when the program was starting up in order to establish reserve funds. These advances, extending over a five-year period, amounted to \$734,173 from 1980 to 1985. In 1988, The guarantee agency returned all advances to the Department of Education. Interest on these federal advances are held in a restricted reserve fund used for purchase of nonreinsured loans.

Table 1 illustrates the annual default rate calculated on the federal fiscal year, October 1st through September 30th. The annual default rate is defined as claims paid for the fiscal year divided by the loans in repayment on October 1st of each year. Please note that the guarantee agency "hit the trigger" during the 1985, 1986 and 1987 fiscal years. The 90% reimbursement rate is calculated on the reimbursement claims submitted after the date(s) the agency's annual default rate exceeds 5%. The 90% reimbursement rate effected the agency's reserves for 2 weeks in 1985, slightly more than 3 months in 1986 and about 2 months in 1987.

In 1987, the Department of Education began charging the guarantee agency a reinsurance fee. The reinsurance fee is 1/4 of 1% of the loans guaranteed during the fiscal year. However, if during the year, an agency's annual default rate is in excess of 5%, the reinsurance fee jumps to 1/2 of 1% of the loans guaranteed during the fiscal year. In 1987, the reinsurance fee for the guarantee agency was \$166,952 for the entire year even though the annual default rate exceeded 5% only for the months of August and September.

TABLE 1

Annual Default Rate		
Fiscal Year End		Reimbursement
<u>September 30th</u>	<u>Default Rate</u>	<u>Received</u>
1980	*	100%
1981	*	100%
1982	*	100%
1983	*	100%
1984	*	100%
1985	5.28%	90%
1986	6.04%	90%
1987	6.68%	90%
1988	4.22%	100%
1989	4.99%	100%
1990	4.83%	100%
1991	3.66%	100%
1992	3.14%	100%

* During the first five years of operations, the guarantee agency was in a grace period where the federal government reimbursed all claim payments at 100% regardless of the agency's default rate.

The next obvious questions is what expenses does the guarantee agency incur? The simplest way to describe expenses is to briefly describe the duties of the guarantee agency in administering the program.

1. General Administration

General administration of the program entails the management and accounting of the agency's records; filing the necessary reports to the Department of Education or the State of Montana; and marketing the student loan program to lenders, schools and students or parent

borrowers. In addition, the agency assists in training lenders and educational institutions of their obligations to the student, the guarantee agency, the Department of Education and each other to ensure the integrity of the loan program; it performs compliance reviews of the lenders and schools to ensure each entity's strict adherence to the laws and regulations governing the program; and other duties as prescribed by the Department of Education or the Board of Regents.

2. Application Processing

Application processing entails processing student loan applications; issuing notices of guarantee to lenders; disbursing checks to student borrowers for those lenders participating in the guarantee agency disbursement service; collecting the guarantee fee or insurance fee from the borrowers through the lenders; answering lender, school and student inquiries relative to loan applications in process; and in some cases correcting errors on rejected applications. A toll free 800 number is provided to enable borrowers to call and check on the status of their loans.

3. Managing the Data Base

Managing the student loan data records entails making the necessary adjustments to the data base resulting from graduation, withdrawal, name and/or address changes, loans paid in full, and school transfers. Maintenance of loans in repayment may require filing deferments for eligible borrowers in an authorized deferment period.

4. Assists Lenders with Delinquent Loans

Upon request, the guarantee agency provides assistance to lenders on delinquent borrowers. When a borrower's account becomes 60-90 days delinquent, the lender requests the guarantee agency to act as a third party to intervene with the borrower. The purpose of this intervention is to try and prevent the borrower from defaulting. This is accomplished through verbal and written communications.

5. Supplemental Pre-Claims Assistance

When an account reaches 120 days of delinquency the loan is transferred to the Supplemental Pre-Claims personnel who perform more extensive counseling activities than in paragraph 4 above.

6. Claims Management

When the lender submits a claim to the guarantee agency on a defaulted, deceased, disabled, or bankrupt borrower, it must be examined to ensure the lender has followed the guarantee agency's and federal regulations in servicing the loan.

Failure by the lender to perform proper due diligence activities results in the loss of the guarantee on the loan. Failure on the part of the guarantee agency to properly examine a lender's claim and improperly purchases a claim results in loss of reinsurance from the Department of Education.

7. Collections

When a loan is defaulted the guarantee agency has the responsibility to continue to collect the money from the defaulter. The collection activities can be accomplished by the guarantee agency itself and/or turned over to collection agencies. In addition the agency has the authority to offset the borrowers' federal and state income tax returns, to garnish the borrower's wages or to obtain a judgement against the borrower.

8. Bankruptcies, Legal Actions, Fraud and Abuse

Normally student loans are not dischargeable through bankruptcies. In some bankruptcy cases, the guarantee agency will have to actively protest the discharged file and specific documents with the court. In other default cases, the guarantee agency can take legal actions against borrowers who are able to pay but do not, or student borrowers who are abusing or attempting to defraud the program. The guarantee agency has a paralegal and attorney available to assist with in-state cases.

The administration of the Guaranteed Student Loan Program can be provided by employees of the guarantee agency or in some cases by third party servicing organization. From 1980 through 1987, the guarantee agency contracted with United Student Aid Funds, Inc. (USA Funds) located in Indianapolis, Indiana, to fully service the loan administration functions. In 1987, the Board of Regents directed the guarantee agency to study the feasibility of bringing some of those functions to Montana. The purpose of the Regents' request was to bring the servicing closer to the clients, i.e., student borrowers, schools and lenders, and to provide jobs to Montanans in Helena. The guarantee agency consummated a servicing contract with USA Funds to provide remote processing in Helena so the various servicing functions could be phased in over a period of time. The first phase, applications processing, commenced in April 1988. By March 1990, all day-to-day functions were being performed in Helena. Attachment A indicates the date each phase of the program was implemented.

A compliance audit has been performed by the Legislative Auditors Office every two years and a financial audit each year. Effective July 1, 1994, the compliance audit must be performed each year instead of every two years.

Attachment A

History of Montana Guaranteed Student Loan Program

Status Management	March 1989
Customer Assistance	October 1988
Fee Billing	April 1989
Pre-Claims Activity	October 1989
Claim Processing	October 1989
Post Claim Activity	February 1990
Accounting, Recoveries, Fiscal Reports	February 1990
Paralegal	October 1990
Supplemental Pre-Claims	February 1991

As stated previously, full servicing is now being conducted in the Helena office. The guarantee agency has received positive response from schools, lenders and borrowers endorsing the move of the servicing function from Indianapolis to Helena. This is reflected in the attached Customer Survey conducted in October 1990 by Anderson ZurMuehlen & Company, Certified Public Accountants.

DATE 3-5-93

SENATE COMMITTEE ON Education

BILLS BEING HEARD TODAY: NB 293, 324, 384

Name	Representing	Bill No.	Check One	
			Support	Oppose
Wayne Buchanan		324 384		X
Bill Loran	Comm. of HE.	293	X	
Eric Oliver	MCA	324 384		X
John Miller	M.F.T.	324 384		X

VISITOR REGISTER

PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY