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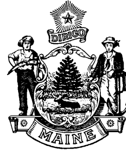

DEPARTMENT OF BUSINESS, OCCUPATIONAL AND PROFESSIONAL REGULATION
BUREAU OF CONSUMER CREDIT PROTECTION
(207)289-3731

ADVISORY RULING #78
DECEMBER 7, 1984

December 7, 1984

Re: Extent of exemption of certain student loan programs from Section 1-202(7)

The Bureau has received an inquiry from a creditor regarding whether or not its proposed student loan program is exempt from The Maine Consumer Credit Code under §1-202(7). Because of the increase in student and parental educational loan programs in Maine, the Bureau felt that an Advisory Ruling on aspects of §1-202(7) was in order.

Subsection 7 of §1-202 was recently amended by P.L. 1983, c. 541. The new version provides that loans or credit sales made exclusively for educational purposes will be exempt from the Code if made pursuant to a federal loan program, or if not made under such a program then if they bear an interest rate not exceeding that allowed under any federal educational loan program and they are insured, guaranteed, subsidized or made directly by the state or federal government, a nonprofit, private loan guarantee authority or organization, the educational institution itself or an endowment or trust fund affiliated with the institution. The new version of §1-202(7) differs from the old in that (1) it includes credit sales; (2) it requires that proceeds of the loan or credit sale be used for educational purposes exclusively; (3) it eliminates the requirement that the loan or credit sale be for attendance at an "institution or higher education"; and (4) it permits the loan or credit sale to be exempt if it is made directly by the educational institution itself (pro-vided, of course, the interest rate does not exceed the maximum allowed under any federal educational loan program). Perhaps the most immediate consequence of the amendment was to permit private elementary and secondary schools to make Code-exempt educational loans to parents to finance their children's education at those schools.

The student loan program subject of the inquiry contains the following features. Loans are made exclusively for educational purposes. The loans carry an interest rate tied to the rate on student loans under the Health Education Assistance Loan (HEAL) Program, an insured loan program administered by the U.S. Department of Health and Human Services. The interest rate under that program is a variable rate, tied to the 91-day Treasury Bill rate, plus 3½%. Loans may only be made to students in attendance at an educational institution that has previously signed an agreement with the creditor in which the institution agrees to subsidize the loan. Subsidization takes two forms: (1) responsibility for rate adjustments beyond a certain level (in effect guaranteeing students a fixed-rate loan), or (2) coverage against default on the loan through the establishment of a bad debt escrow account, the purchase of insurance, etc.

Two questions have arisen regarding the application of the statute to the loan program described above. First, does the tying of the rate charged under the creditor's student loan program

to that charged under an "insured" federal student loan program thereby exempt the creditor's loan program from the Code; and second, is the fact that under the variable rate program a subsidization of rates may never materialize (because rates could remain steady or fall) fatal to the requirement of subsidization in order for the loan to be exempt.

Turning to the first question, the mere fact that the HEAL loan program to which the rate is tied is "insured by the Federal Government" does not make the creditor's loan exempt when its loan is not made under that program. If the loan were made under the HEAL program then obviously it would be Code-exempt for the loan would made pursuant to a federal educational loan program. However, when the HEAL rate is merely borrowed and the loan is not made pursuant to that program, the fact that under the HEAL loan program the loan is "insured" has no bearing on whether or not the creditor's loan is Code-exempt. A second examination must be made to determine if the student loan is somehow otherwise insured, subsidized or made by the institution (trust fund, etc.) involved. Assuming any of those three conditions exists, the loan would be Code-exempt.

Regarding subsidization, two means of subsidy were offered: rate subsidy and risk subsidy. Clearly, if default insurance, whether purchased by the educational institution through a carrier or provided by the institution itself through an escrow fund, is provided, the loan is subsidized for purpose of §1-202(7) and the exemption applies. The more difficult question involves rate subsidies, for it is conceivable that the school's obligation to subsidize upward rate movements might never be triggered if rates remain steady or fall. Because no one can predict interest rate movement, it is the Bureau's view that the willingness of the institution to incur the liability of rate increases is tantamount to a subsidy. If rates are stable, or actually fall, the student borrower is in no way harmed in that he pays no more than originally expected. without the willingness of the educational institution to absorb the risk of rising rates, however, and thereby lessen the risk of the student's default, the student borrower would have been unable to obtain the loan. Such contingent liability can, in the proper circumstances, equate to a subsidy. In making this determination, however, the Bureau reserves the right to conclude that contingent liability does not equate to a subsidy in other circumstances. If the index to which the rate is tied is stable or the time period over which adjustments can be made is long (such that rate movements are minimized), or if the rate increase that will be required to trigger the school's subsidy is large, the subsidy may be more theoretical than real and the exemption from §1-202(7) should not apply.

It should be remembered that unless the student loan program is one which has been expressly made exempt from the requirements of truth-in-lending by recent federal legislation, disclosures under Article VIII of the Code must still be made.

/s/ Robert A. Burgess
Robert A. Burgess, Superintendent

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