9.a

Action/Information Item

California Student Aid Commission

Consideration of Commission Policy on EDFUND Incentive Compensation

The April 2006 Bureau of State Audits (BSA) recommended that the Commission:

- Ensure that EDFUND determines bonuses for its president in accordance with Commission policy;
- Modify its policy to ensure that EDFUND's EMT does not receive a bonus if the Federal Family Education Loan (FFEL) Program or Operating Fund realizes a deficit; and
- Ensure that EDFUND includes all FFEL Program revenues and expenses in its calculation of the program's operating surplus or deficit.

In response to BSA, the Commission directed the EDFUND Board to make a recommendation regarding the Commission Policy on EDFUND Incentive Compensation to the Commission for review and approval.

The EDFUND Board's recommendation was presented to the Commission at its April 18-20, 2007 Commission meeting. CSAC staff raised two issues regarding the EDFUND proposal for the Commission Policy on EDFUND Incentive Compensation:

1. Precondition for Incentive Compensation.
2. Conformity with Roles and Responsibilities.

The Commission deferred discussion of Conformity with Roles and Responsibilities until finalized by the Commission. However, after a lengthy discussion, the Commission approved the following precondition statement for the Commission Policy on EDFUND Incentive Compensation:

> "A precondition for incentive compensation requires that the year-end Loan Program Revenues Net of Expenses will be a surplus and no less than 75% of the Loan Program Revenues Net of Expenses as approved by the Commission in the annual Loan Program Business Plan and Budget and any subsequent approved change to the budget."

During the Commission's April 18-20, 2007 meeting there was also a discussion regarding BSA's recommendation that the Student Aid Commission ensure that it and EDFUND's Board establish guidelines to use when approving the total bonus pool amount for EDFUND Executive Management Team. EDFUND Board Chair Furay suggested that EDFUND provide alternatives to the Policy on Incentive Compensation and make recommendations to the Commission at its June meeting.

The EDFUND Board met on May 16, 2007 approved the enclosed revised Commission Policy on EDFUND Incentive Compensation. (Tab 9.a.1) and recommended submitting it to the Commission for their consideration.

The Board's proposed policy changes the discretionary executive incentive compensation to non-discretionary and limits the Commission's responsibility regarding incentive compensation to approval of the total incentive compensation pool for all EDFUND employees in the annual budget and the annual EDFUND goals in the annual loan program business plan.

The Board's proposed policy also modifies the precondition statement for incentive compensation approved by the Commission as noted above. The changes to the precondition statement are shown in bold below:

"The preconditions for incentive compensation shall require that:

A. The year-end "Loan Program Revenues Net of Expenses" be a surplus, <u>and</u>

B. The year-end "Loan Program Revenues Net of Expenses" be no less than seventy-five (75) percent of what was approved by the ***EDFUND Board of Directors*** and the Commission in the annual Loan Program Business Plan, Budget, and Goals and any subsequent approved ***revision*** to the budget.

Commission staff recommends that the EDFUND executive incentive compensation remain discretionary and that the language for the precondition for incentive compensation reflect the language approved by the Commission.

Responsible Staff: Janet McDuffie
Chief, Management Services and
Acting Chief, Federal Policy & Programs

David Reid
General Counsel and Vice President
EDFUND Legal Services

DRAFT

CALIFORNIA STUDENT AID COMMISSION
50 Years Serving Students 1955-2005

GENERAL POLICY

SUBJECT:
EDFUND Incentive Compensation

POLICY NUMBER:
02

EFFECTIVE DATE:
July 1, 2007

APPROVED BY COMMISSION SECRETARY

INTRODUCTION

Pursuant to California Education Code Sections 69522 et seq., the California Student Aid Commission (the Commission) formed EDFUND as an auxiliary organization to perform operational and support services essential for the administration of the Federal Family Education Loan Program. It is the Commission's intention that EDFUND function as a performance based organization. EDFUND will offer its employees incentive compensation plans in furtherance of this intent. The EDFUND Board of Directors has been designated as responsible to the Commission for the establishment of EDFUND's incentive compensation plans. This policy provides the Commission's guidelines for EDFUND's Incentive Compensation Plans.

COMMISSION'S INCENTIVE COMPENSATION PHILOSOPHY

The Commission's incentive compensation philosophy for EDFUND is based on the following principles:

- The combination of EDFUND's base pay and incentive compensation should be consistent with reasonable, competitive compensation practices of similarly situated organizations.
- The provision of incentive compensation must reflect the prudent use of funds provided to EDFUND for its administration and operation of the Federal Family Education Loan Program.
- Incentive compensation should promote and reflect organizational and individual performance and accountability by setting challenging, yet achievable goals that support the organization's mission and strategic objectives.
- Incentive compensation should help to attract, retain and motivate high quality employees.

INCENTIVE COMPENSATION PLAN ADMINISTRATION

The EDFUND Board of Director's is responsible for developing and approving corporate policies and procedures that address plan eligibility; plan design; organizational, departmental and individual performance goals and objectives; goals measurement; review and evaluation; approval processes; and distribution mechanism. The goals, at a minimum, should be specific, measurable, achievable, relevant, and timely. Departmental and individual goals should be aligned with the goals of the organization. The policies and goals shall comply with the United States Internal Revenue Code of 1986, as amended.

INCENTIVE COMPENSATION PLANS

EDFUND shall maintain the following incentive compensation plans pursuant to limitations contained within this policy and EDFUND policies and procedures:

- EDSHARE: This plan awards incentive compensation to at-will employees (except for Client Relations Managers, Executive Management, and Internal Collection Staff) based on a company performance component and an individual performance component. Incentive Compensation for individuals, whose position is a grade 8N or above, within this plan shall be fifteen (15) percent of their base salary but may be adjusted lower based upon the extent to which individual performance goals and the Company performance goals for the EDFUND fiscal year are achieved. Incentive Compensation for individuals, whose position is a grade 7N or below, within this plan shall be eleven (11) percent of their base salary but may be adjusted lower based upon the extent to which individual performance goals and the Company performance goals for the EDFUND fiscal year are achieved.

- EDSHARE for Client Relations Managers: This plan awards incentive compensation to Client Relations Managers based on a company performance component and an individual performance component. Incentive Compensation for individuals within this plan shall be twenty (20) percent of their base salary but may be adjusted lower based upon the extent to which individual performance goals and the Company performance goals for the EDFUND fiscal year are achieved.

- EDSHARE for Executive Management: This plan awards incentive compensation to Executive Management (the President and Vice Presidents) based on a company performance component and an individual performance component. Incentive Compensation for individuals within this plan shall be twenty (20) percent of their base salary but may be adjusted lower based upon the extent to which individual performance goals and the Company performance goals for the EDFUND fiscal year are achieved.

PROCESS

The following administrative process shall be followed by the Commission and EDFUND in the budget development process as it relates to incentive compensation:

1. Incentive compensation plans will be reflected in the annual EDFUND budget as a part of total salaries and benefits. The annual EDFUND Budget shall be approved by the EDFUND Board of Directors and the Commission in accordance with the provisions of the Operating Agreement.

2. The annual EDFUND Goals shall be the basis for calculating the company performance component of the EDSHARE plans. The annual EDFUND Goals shall be approved by the EDFUND Board of Directors and the Commission in accordance with the provisions of the Operating Agreement.

3. At fiscal year end, the percentage of accomplishment EDFUND has achieved toward the annual EDFUND Goals will be calculated according to the formula approved by the EDFUND Board of Directors and the Commission in the annual Loan Program Business Plan, Budget, and Goals and used to determine payments to employees qualifying for the EDSHARE plans.

4. The preconditions for incentive compensation shall require that:

   A. The year-end “Loan Program Revenues Net of Expenses” be a surplus <u>and</u>

   B. The year-end “Loan Program Revenues Net of Expenses” be no less than seventy-five (75) percent of what was approved by the EDFUND Board of Directors and the Commission in the annual Loan Program Business Plan, Budget, and Goals and any subsequent approved revision to the budget.

5. All incentive compensation payments shall be made within seventy-five (75) days of the end of EDFUND's fiscal year.

CSAC **POLICY STATEMENT AND GUIDELINES MEMO**		CONTROL NUMBER
SUBJECT: **EDFUND Incentive Compensation Plans**		EFFECTIVE DATE ~~August 12, 2002~~
APPROVED BY:	APPROVED BY:	EXPIRES:

Introduction

Pursuant to California Education Code Sections 69522 et seq., the California Student Aid Commission (the Commission) formed EDFUND as an auxiliary organization to perform operational and support services essential to the administration of the Federal Family Education Loan ~~FFEL~~ Program. It is the Commission's intention that EDFUND function as a performance based organization. EDFUND offers its employees incentive compensation plans in furtherance of this intent. The EDFUND Board of Directors has been designated as responsible to the Commission for the establishment of EDFUND's incentive compensation plans. This memorandum provides the Commission's guidelines for EDFUND's Incentive Compensation Plans.

COMMISSION'S INCENTIVE COMPENSATION PHILOSOPHY

The Commission's incentive compensation philosophy for EDFUND is based on the following principles:

- The combination of EDFUND's ~~basic~~ base pay and incentive compensation should be consistent with reasonable, competitive compensation ~~take into consideration the~~ practices of similarly situated organizations ~~and reflect the actual worth of work done by employees of the organization~~.
- The provision of incentive compensation must reflect the prudent use of funds provided to EDFUND for its administration and operation of the Federal Family Education Loan Program.
- Incentive compensation should promote and reflect organizational and individual performance and accountability by setting challenging, yet achievable~~,~~ goals that support the organization's mission and strategic objectives.
- Incentive compensation should help to attract, retain and motivate employees.

~~The EDFUND Board of Directors has been designated as responsible to the Student Aid Commission for the establishment of EDFUND'S incentive compensation plans.~~

INCENTIVE COMPENSATION PLAN ADMINISTRATION

EDFUND is responsible for developing corporate policies and procedures that address plan eligibility; plan design; organizational, departmental and individual performance goals and objectives; goals measurement; review and evaluation; approval processes; and the funding and distribution mechanism. The goals, at a minimum, should be specific, measurable, achievable, relevant, and timely. Departmental and individual goals should be aligned with the goals of the organization.

NON-EXECUTIVE INCENTIVE COMPENSATION PLANS

~~**Variable Pay Plans**~~
A. Number of Plans

There are three non-executive incentive compensation~~The following variable pay~~ plans that have been agreed to by the EDFUND Board and the Commission. These plans allow EDFUND to offer incentive compensation to designated employees:

- EDSHARE Variable Pay Plan for all employees except Client Relations Managers and Internal Collection Staff: This plan awards incentive compensation based on two components - - a company performance component and an individual performance component.

- EDSHARE Incentive Pay Plan for Client Relations Managers: This plan awards incentive compensation based on two components - - a company performance component and an individual loan volume performance component.

- ~~EDSHARE~~COLLECTION COMMISSION ~~Variable Pay~~ Plan for ~~Internal Collectors and~~ Internal Collection ~~Supervisors~~Staff: This plan awards incentive compensation based on performance against established collection net revenue targets.

- ~~EDSHARE Variable Pay Plan for all other employees other than EDFUND's Executive Management.~~

~~For each of these agreed upon variable pay plans, EDFUND is responsible for developing corporate policies and procedures that address plan eligibility, plan design, organizational, departmental and individual performance goals and objectives, goals measurement, review and evaluation, approval processes, and the funding and distribution mechanism. The goals, at a minimum, should be specific, measurable, achievable, relevant, and timely. Departmental and individual goals should be aligned with the goals of the organization.~~

The EDFUND Board of Directors and the Commission's Executive Director are responsible for approving ~~these initial plans~~incentive compensation plans and any subsequent changes to the ~~variable pay~~ plans. Each plan contains a specified cap. ~~Variable pay~~Incentive compensation plans that are specified in the ~~o~~Operating ~~a~~Agreement will be reflected in the EDFUND budget as a part of total wages and salaries.

B. Company Performance Component of EDSHARE Plans

~~The variable pay plan structure provides EDFUND participants the opportunity to receive incentive pay based upon the achievement of individual and/or corporate objectives. With respect to the attainment of corporate goals and objectives, a~~

At fiscal year end, the Commission~~'s Executive Director~~ will assess the percentage of accomplishment EDFUND has achieved toward the ~~"California Student Aid Commission's Performance Goals for EDFUND" as~~ high-level organizational goals as contained in the

Loan Program Business Plan that is approved by the EDFUND Board and the Commission in accordance with the provision ~~pursuant to Exhibit C~~ of the Operating Agreement. The company performance measure is an element in the formula to determine payments to employees qualifying for the EDSHARE plans.

C. Approval Process

1. At fiscal year end, the EDFUND Board recommends to the Executive Director and to the Commission Chair the percentage of company goals accomplished.
2. The Executive Director ~~will~~ reports his/her ~~findings~~ recommendation to the Commission Chair who ~~will~~ either concurs or modif~~y~~ies that recommendation on behalf of the Commission.
3. Once the decision on company performance percentage is made, the Commission Chair communicates this percentage to the EDFUND Board.
4. If either the Executive Director or the ~~President of~~ EDFUND Board disagrees with the decision rendered by the Commission Chair, one or both may request a review by the Commission. This review would be performed at the next scheduled meeting of the Commission. ~~A vote of the majority~~The decision of the Commission ~~will be the~~is final ~~decision on this matter~~. ~~Once the decision on Company performance is made, the Executive Director will communicate this percentage of performance to EDFUND and EDFUND will, given that percentage, prepare a summary of the total payment to be made under the variable pay plans for the Executive Director's review. The Commission's Executive Director will approve in writing the payments for reimbursement from the Operating Fund.~~
5. All activities associated with this process should be completed so as to ensure payment within seventy-five (75) days of the end of EDFUND's fiscal year.

DISCRETIONARY EXECUTIVE INCENTIVE COMPENSATION

EDFUND's executive management team, consisting of its President and Vice Presidents, may receive incentive compensation under the terms of this policy. A precondition for ~~this~~ incentive compensation ~~is that the loan program has been managed to~~ will require that a year end net operating surplus ~~or deficit at least as positive as the budget (as revised) for the year~~ for the loan program be a threshold for incentive compensation payment, excluding ~~the revenue and expenditures related to the Voluntary Flexible Agreement and~~ any non-loan program expenditures ~~directed by the Commission~~.

The Commission places responsibility to ~~propose~~ determine the amounts of Executive Incentive Compensation payment with the EDFUND Board or its designated committee, subject to the steps specified in numbers 4 and 5 below. The EDFUND Board shall make every effort to establish a presumption that the incentive compensation payment provided to its President and Vice Presidents is reasonable, as such presumption is contemplated in Section 4958 of the Internal Revenue Code of 1986, as amended. The Executive Compensation Plan contains a specified cap.

Approval Process

1. At ~~the~~ fiscal year end, the EDFUND Board ~~will~~ provides the ~~Commission's~~ Executive Director and the Commission Chair with documentation that details the overall performance of EDFUND and an assessment of the individual performance of ~~the corporation~~EDFUND's President. ~~This documentation should include the Board's assessment of the percentage of~~

~~accomplishment EDFUND has achieved toward the "California Student Aid Commission's Performance Goals for EDFUND" as contained in the Business Plan pursuant to Exhibit C of the Operating Agreement if the Board's performance assessment is different from the Executive Director's assessment prepared for the Variable Pay Plans.~~

2. The EDFUND Board ~~shall~~ also recommends to the Executive Director and to the Commission Chair the proposed incentive compensation amount~~, if any,~~ for the President and the total incentive compensation pool amount for the Executive Management Team.
3. The Executive Director ~~shall review and make~~ reports his/her recommendation on the performance assessment and the proposed incentive compensation amounts for the President and the total incentive compensation pool amount for Executive Management Team ~~and forward the entire matter~~ to the Commission Chair ~~of the Commission~~.
4. The Commission Chair ~~of the Commission will~~ evaluates the Board's report and the Executive Director's report~~s~~ and ~~will~~ determines whether or not the Incentive Compensation amounts ~~which are~~ proposed by the EDFUND Board are appropriate.
5. The Commission Chair ~~of the Commission will then determine what, if any,~~ either concurs or modifies the incentive compensation amounts ~~for the President and the Executive Management Team will be~~ and communicates his/her decision to the EDFUND Board. Any modification that increases incentive compensation amounts shall be returned to the EDFUND Board for determination of reasonableness.
6. If either the Executive Director~~Board~~ or the ~~Executive Director~~ EDFUND Board ~~does not~~ disagrees with the decision rendered by ~~of~~ the Commission Chair ~~of the Commission~~, ~~they~~ one or both may request a closed session review by the ~~full~~ Commission. This review would be performed ~~which will be held~~ at the next scheduled meeting of the Commission. The decision of the Commission ~~will be~~ is final.
7. ~~While the Executive Director and the Commission Chair shall each have five (5) working days for their respective actions, a~~All activities associated with this process should be completed so as to ensure payment within seventy-five (75) days of the end of EDFUND's fiscal year.

~~High Level Executive Incentive Compensation Process Flow and Tasks~~

~~EDFUND Executives~~ →	~~EDFUND Board~~ →	~~Commission Executive Director~~ →	~~Commission Chair~~ →	~~Full Commission (if required)~~
~~Perform executive evaluations.~~ ~~Perform and prepare assessment of the performance of EDFUND.~~	~~Evaluate information Submitted by the President~~ ~~Propose incentive compensation for executives and submit to Commission's Executive Director, along with supporting documentation~~.	~~Perform and prepare assessment of the overall Performance of EDFUND.~~ ~~Review documentation and recommendation of the Board.~~ ~~Make formal recommendations And forward all materials to Commission Chair.~~	~~Review documentation received from the EDFUND Board and The Commission's Executive Director.~~ ~~Approve President's Incentive Compensation and final total amount of payout for EDFUND executives.~~	~~Review and, if warranted, adjust Commission Chair's final position.~~

CSAC POLICY STATEMENT AND GUIDELINES MEMO		CONTROL NUMBER
SUBJECT: **EDFUND Incentive Compensation Plans**		EFFECTIVE DATE August 12, 2002
APPROVED BY:	APPROVED BY:	EXPIRES:

Introduction

Pursuant to California Education Code Sections 69522 et seq., the Commission formed EDFUND as an auxiliary organization to perform operational and support services essential to the administration of the FFEL Program. It is the Commission's intention that EDFUND function as a performance based organization. EDFUND offers its employees incentive compensation plans in furtherance of this intent. This memo provides the Commission's guidelines for EDFUND's Incentive Compensation Plans.

The Commission's incentive compensation philosophy is based on the following principles:

- The combination of EDFUND's basic and incentive compensation should take into consideration the practices of similar organizations and reflect the actual worth of work done by employees of the organization.

- The provision of incentive compensation must reflect the prudent use of funds provided to EDFUND for its administration and operation of the Federal Family Education Loan Program.

- Incentive compensation should promote organizational and individual performance and accountability by setting challenging, yet achievable, goals.

- Incentive compensation should help to attract, retain and motivate employees.

The EDFUND Board of Directors has been designated as responsible to the Student Aid Commission for the establishment of EDFUND's incentive compensation plans.

Variable Pay Plans
The following variable pay plans have been agreed to by EDFUND and the Commission. These plans allow EDFUND to offer incentive compensation to designated employees:

- EDSHARE Incentive Pay Plan for Client Relations Managers.

- EDSHARE COLLECT Variable Pay Plan for Internal Collectors and Internal Collection Supervisors.

- EDSHARE Variable Pay Plan for all other employees other than EDFUND's Executive Management.

For each of these agreed upon variable pay plans, EDFUND is responsible for developing corporate policies and procedures that address plan eligibility, plan design, organizational, departmental and individual performance goals and objectives, goals measurement, review and evaluation, approval processes, and the funding and distribution mechanism. The goals, at a minimum, should be specific, measurable, achievable, relevant, and timely. Departmental and individual goals should be aligned with the goals of the organization.

The EDFUND Board of Directors and the Commission's Executive Director are responsible for approving these initial plans and any subsequent changes to the variable pay plans. Variable pay plans that are specified in the operating agreement will be reflected in the EDFUND budget as a part of total wages and salaries.

The variable pay plan structure provides EDFUND participants the opportunity to receive incentive pay based upon the achievement of individual and/or corporate objectives. With respect to the attainment of corporate goals and objectives, at fiscal year end, the Commission's Executive Director will assess the percentage of accomplishment EDFUND has achieved toward the "California Student Aid Commission's Performance Goals for EDFUND as contained in the Business Plan pursuant to Exhibit C of the Operating Agreement. The Executive Director will report his/her findings to the Commission Chair who will either concur or modify that recommendation on behalf of the Commission. If either the Executive Director or the President of EDFUND disagree with the decision rendered by the Commission Chair, one or both may request a review by the Commission. This review would be performed at the next scheduled meeting of the Commission. A vote of the majority of the Commission will be the final decision on this matter. Once the decision on Company performance is made, the Executive Director will communicate this percentage of performance to EDFUND and EDFUND will, given that percentage, prepare a summary of the total payment to be made under the variable pay plans for the Executive Director's review. The Commission's Executive Director will approve in writing the payments for reimbursement from the Operating Fund.

Discretionary Executive Incentive Compensation

EDFUND's executive management team, consisting of its President and Vice Presidents, may receive incentive compensation under the terms of this policy. A precondition for this compensation is that the loan program has been managed to a year end operating surplus or deficit at least as positive as the budget (as revised) for the year, excluding the revenue and expenditures related to the Voluntary Flexible Agreement and any non-loan program expenditures directed by the Commission.

The Commission places responsibility to propose the amounts of Executive Incentive Compensation payment with the EDFUND Board or its designated committee.

At the fiscal year end, the EDFUND Board will provide the Commission's Executive Director with documentation that details the overall performance of EDFUND and an assessment of the individual performance of the corporation's President. This documentation should include the Board's assessment of the percentage of accomplishment EDFUND has achieved toward the "California Student Aid Commission's Performance Goals for EDFUND" as contained in the Business Plan pursuant to Exhibit C of the Operating Agreement if the Board's performance assessment is different from the Executive Director's assessment prepared for the Variable Pay Plans. The Board shall also recommend the proposed incentive compensation amount, if any, for the President and the total incentive compensation amount for the Executive Management Team. The Executive Director shall review and make his/her recommendation on the performance assessment and the proposed incentive compensation amounts for the President and the Executive Management Team and forward the entire matter to the Chair of the Commission.

The Chair of the Commission will evaluate the Board's and the Executive Director's reports and will determine whether or not the Incentive Compensation amounts which are proposed by the EDFUND Board are appropriate. The Chair of the Commission will then determine what, if any, the incentive compensation amounts for the President and the Executive Management Team will be. If either the Board or the Executive Director does not agree with the decision of the Chair of the Commission, they may request a closed session review by the full Commission which will be held at the next scheduled meeting of the Commission. The decision of the Commission will be final. While the Executive Director and the Commission Chair shall each have five (5) working days for their respective actions, all activities associated with this process should be completed so as to ensure payment within seventy-five (75) days of the end of EDFUND's fiscal year.

High Level Executive Incentive Compensation Process Flow and Tasks

EDFUND Executives →	EDFUND Board →	Commission Executive Director →	Commission Chair →	Full Commission (if required)
Perform executive evaluations. Perform and prepare assessment of the performance of EDFUND.	Evaluate information Submitted by the President Propose incentive compensation for executives and submit to Commission's Executive Director, along with supporting documentation.	Perform and prepare assessment of the overall Performance of EDFUND. Review documentation and recommendation of the Board. Make formal recommendations And forward all materials to Commission Chair.	Review documentation received from the EDFUND Board and The Commission's Executive Director. Approve President's Incentive Compensation and final total amount of payout for EDFUND executives.	Review and, if warranted, adjust Commission Chair's final position.

9.b

Action/Information Item

California Student Aid Commission

Consideration of EDFUND Policy on Executive Compensation

The Bureau of State Audits (BSA) April 2006 report found that EDFUND's policy does not meet federal requirements for executive salary determination, nor does EDFUND adhere to all elements of its policy. BSA recommended that the Commission ensure that EDFUND complies fully with federal regulations and its policy governing salary setting for its executives, including modifying its policy to address Board Members who have a conflict of interest and ensuring that its consultants compile comparable compensation data solely from similar financial related organizations. The Commission process established in response to BSA's recommendation requires that the EDFUND Board seek advice of outside legal counsel on the adequacy of the compensation comparison methodology used by EDFUND in meeting federal requirements for nonprofit tax-exempt organizations.

The EDFUND Personnel and Nominations (PEN) Committee developed a draft Executive Compensation Policy, in consultation with Watson Wyatt, the consulting firm engaged to assist the EDFUND Board with the review of existing executive salary policy and process. The EDFUND PEN Committee also requested a legal opinion from the law firm of Foley & Lardner, LLP to be provided to the EDFUND Board prior to Board approval. Based upon the legal opinion, dated March 17, 2007, several minor changes were made to the draft policy, including the addition of an incentive compensation cap. A copy of the legal opinion is enclosed (Tab 9.b.1).

EDFUND staff presented the enclosed draft EDFUND Executive Compensation Policy to the EDFUND Board on April 9, 2007. Although the EDFUND Board agreed to some revisions, CSAC staff still had concerns regarding EDFUND's proposed precondition for incentive compensation, the need for conformance with the Commission's roles and responsibilities, and the selection of peer group data.

At the April 18-20, 2007 Commission meeting, the Commission did not discuss EDFUND's proposed Executive Compensation Policy. Therefore, the following concerns are still outstanding:

1. <u>Precondition for Incentive Compensation</u>

   The proposed EDFUND Policy on Executive Compensation currently states the following:

   > *"There is a requirement that a positive operating margin for the loan program be a threshold for payment of any award and be consistent with the CSAC Policy Statement and Guidelines on EDFUND Incentive Compensation Plans."* [Tab 9.b.2, page 2, Annual Incentive Plan (AIP), 3rd bullet]

   BSA recommended that the EDFUND Executive Management Team (EMT) should not receive a bonus if the Federal Family Education Loan (FFEL) Program or Operating Fund realizes a deficit. This precondition statement does meet a portion of the BSA recommendation. However, EDFUND staff has indicated that IRS guidelines specify that the person receiving incentive compensation for achieving a performance goal must have meaningful influence or control over the achievement of that goal. Therefore, EDFUND can only be held accountable for the FFEL Program operating surplus. CSAC staff concurs with EDFUND's assessment and agrees that because the Operating Fund also funds non-loan program items, EDFUND cannot be held accountable for those budget items. However, the precondition included in the draft policy may not necessarily meet the Commission's expectations regarding the loan program surplus. When the Commission approves the budget, it approves a specific loan program operating surplus, also known as "Loan Program Revenues Net of Expenses."

At its April 18-20, 2007 meeting, the Commission discussed the Commission Policy on EDFUND Incentive Compensation and approved the following precondition statement:

> *"A precondition for incentive compensation requires that the year-end Loan Program Revenues Net of Expenses will be a surplus and no less than 75% of the Loan Program Revenues Net of Expenses as approved by the Commission in the annual Loan Program Business Plan and Budget and any subsequent approved change to the budget."*

The EDFUND Executive Compensation Policy's precondition statement should be consistent with the approved precondition statement for other EDFUND employee incentive compensation.

2. Conformity with Roles and Responsibilities

   Throughout the current draft are references to the Commission Chair's responsibilities. At the April 9, 2007 EDFUND Board meeting, CSAC staff reminded the Board that the responsibilities of the Chair of the Commission were still being discussed as the Commission develops the roles and responsibilities. The issue of conformity with roles and responsibilities was noted at the April 18-20, 2007 Commission meeting. The Commission deferred discussion of this issue until after the roles and responsibilities are finalized.

3. Executive Compensation - Peer Group Data

   Page 5 of the draft policy indicates that the EDFUND PEN Committee will use comparative data from peer groups in its analysis of the relevant market data for each position with the EMT. CSAC staff has concerns regarding the selection of the peer group and the limitation of the peer group to non-profit organizations. On November 17, 2006 and, again, on April 9, 2007, CSAC staff requested a copy of the Executive Level Assessment to better understand how the peer groups were selected and used in the determination of the appropriate market levels for comparison and to assess each incumbent executive accordingly. EDFUND staff provided a list of entities in the peer group on April 6, 2007; however, it did not address CSAC staff's specific request for the material from Watson Wyatt that explains how the consultant arrived at the peer group and other determinations. To date, this information has not been provided. At its April 9, 2007 meeting, the EDFUND Board discussed the issue raised by CSAC staff and decided not to make any changes to the policy as this policy falls under the responsibilities of the EDFUND Board.

CSAC staff is not in a position to either endorse or recommend changes to the policy without the information requested above. Upon receipt of the requested information, CSAC staff will work with EDFUND staff to develop a mutually agreed upon policy.

Responsible Staff:	Janet McDuffie Chief, Management Services and Acting Chief, Federal Policy & Programs	David Reid General Counsel & Vice President EDFUND Legal Services

FOLEY

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CLIENT/MATTER NUMBER
077140-0106

March 17, 2007

The Board of Directors
EDFUND
3300 Zinfandel Drive
Rancho Cordova, California 95670

Re: Executive Compensation Policy

Ladies and Gentlemen:

You have asked for our opinion with respect to a proposed Executive Compensation Policy (the "EDFUND Policy") under review by the EDFUND Board, as well as a Policy Statement and Guidelines Memorandum adopted by the California Student Aid Commission ("CSAC"), entitled "EDFUND Incentive Compensation Plans" (the "CSAC Policy"). CSAC is considering revisions to the CSAC Policy and has asked the EDFUND Board to comment on the same.

This letter reflects our opinion whether the EDFUND Policy and the CSAC Policy are consistent with: (i) the requirements of the California Nonprofit Integrity Act; and (ii) the prohibitions against "private inurement," "private benefit" and "excess benefits" applicable to organizations exempt from tax pursuant to Section 501(c)(3) of the Internal Revenue Code ("IRC"). Except as specifically noted, we consider the EDFUND Policy and the CSAC Policy together as a unit (collectively, the "Policies").

Summary of Opinions

Based on our understanding of the facts and our analysis of the law, we are of the opinion that:

1. The Policies comply with the California Nonprofit Integrity Act.

2. The Policies are consistent with the "private inurement," "private benefit" and "excess benefits" doctrines.

   a. These doctrines require that executive compensation be reasonable in amount. It is our opinion that the procedures the Policies provide for are consistent with guidelines that have been developed under law and by the IRS for assuring the reasonableness of compensation. Moreover, it is our opinion that compensation established in accordance with the Policies

FOLEY

FOLEY & LARDNER LLP

will qualify for the "presumption of reasonableness" under IRC Section 4958.

b. The private inurement and private benefit doctrines, however, present requirements for incentive compensation arrangements in addition to reasonableness of amount. In our opinion, subject to the limitations noted below, the Policies are consistent with these additional requirements.

- An incentive compensation system may not: (i) have performance goals that improperly motivate conduct inconsistent with tax exempt purposes; and (ii) provide incentive compensation to a person based on the achievement of a performance goal unless that person has meaningful influence or control over the achievement of that goal. Here, no performance goals have yet been adopted under the Policies. However, the Policies contain guidelines for adoption of performance goals that would meet these requirements. Therefore, the Policies should be adequate, provided that their guidelines are followed.

- IRS guidelines require that incentive compensation arrangements have a "cap" to assure that they do not result in any unreasonable compensation "windfalls." As written, the Policies do not establish a cap, but do require a specific determination that each and every award of incentive compensation be reasonable in amount. We believe that this requirement serves as the functional equivalent of a cap. However, if the IRS were to examine the Policies, it would likely question the lack of a cap.

Analysis

1. *The California Nonprofit Integrity Act*

In relevant part, the California Nonprofit Integrity Act (the "Act") requires that the board of directors of a public benefit corporation, such as EDFUND, review and approve the compensation of its president or chief executive officer, as well as its treasurer or chief financial officer to assure that such compensation is "just and reasonable." California Government Code Section 12586(g).

The Policies cover the compensation of EDFUND's President and Vice Presidents, including, we understand, one Vice President who has the duties of a treasurer/CFO. Accordingly, the Policies cover the positions required by the Act.

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However, the Policies provide that all awards of incentive compensation are subject to concurrence or modification by the CSAC Chair. Modification might include an increase, and the increased amount would not be compensation approved by the EDFUND board, as required by the Act. The EDFUND Policy provides that the CSAC Chair shall not increase the amount of a proposed award of compensation, but the EDFUND Policy does not bind the CSAC Chair. In order to better assure compliance with the Act, we recommend either that: (i) the CSAC board amend the CSAC Policy to provide that the CSAC Chair may only approve or decrease, but not increase, any proposed incentive compensation award; or (ii) the EDFUND board amend the EDFUND Policy to provide that the EFUND board shall review any increase approved by the CSAC Chair and shall pay the increase only if the EDFUND board determines that such increase is reasonable.

2. *Private Inurement, Private Benefit and Excess Benefits Rules.*

a. Reasonableness; Presumption of Reasonableness. While the private inurement, private benefit, and excess benefit doctrines differ from each other in various respects, they all prohibit organizations exempt from tax under IRC Section 501(c)(3) from excessively compensating their executive officers. An exempt organization that unreasonably compensates its executives jeopardizes its exempt status and exposes the unreasonably compensated executives, as well as the board members or others who approved the compensation, to monetary fines.

Courts and the IRS have begun to recognize certain "best practices" as a means to assure that executive compensation is reasonable. In promulgating regulations under IRC Section 4958 (which sets out the penalties for excess benefit transactions), the IRS has collected these best practices, and has provided that compensation approved in accordance with them is entitled to a "presumption of reasonableness." Obtaining a presumption of reasonableness is important. If the IRS decides to challenge the reasonableness of compensation approved in accordance with these practices, it will bear the burden of proving that the compensation is unreasonable. *See,* Treas. Reg. Section 53.4958-6. Otherwise, the taxpayer bears the burden of proof.

Three basic procedural requirements must be satisfied for compensation to qualify for the presumption of reasonableness:

- First, the compensation of the principal executive officers must be approved by the organization's board of directors (or a committee to which the board has delegated approval authority), and all members of the board (or committee) participating in the approval process must be free of all conflicts of interest, as defined in the regulations.

  As discussed above, the Policies address the "Board approval" requirement by stipulating that the EDFUND Board must approve all executive compensation. However, as noted above, to have greater confidence in the sufficiency of the Policies, either: (i) the CSAC Board should amend the CSAC Policy to prohibit the CSAC Chair from increasing any proposed incentive compensation; or (ii) the

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EDFUND Board should amend the EDFUND Policy to provide that the EFUND board shall review any increased incentive approved by the CSAC Chair and shall pay the increase only if the EDFUND board determines that the increase is reasonable.

The EDFUND Policy also addresses the conflict of interest rule by providing that each member of the Board, Executive Committee and Personnel and Nominations ("PEN") Committee who participates in compensation discussions and decisions shall be free from all conflicts of interest. The EDFUND Policy adopts the definition of "conflicts of interest" that is used in the regulations under IRC Section 4958. Accordingly, the Policies satisfy the first procedural requirement.

- Second, the board (or committee), in considering the reasonableness of a proposed compensation arrangement, must have before it and rely on objective criteria that support the reasonableness of the proposed compensation amount.

  The EDFUND Policy does provide for the development of and reliance on objective criteria of reasonableness. Specifically, the EDFUND Policy directs the PEN Committee to obtain and review "comparable data from a select peer group of not-for-profit student loan operations with an emphasis on revenue, budget, complexity and mission." The EDFUND Policy further provides that the Executive Committee and the Board will both receive such data (or summaries of it), augment the data received as appropriate, and establish compensation based on the criteria so developed. Accordingly, the Policies satisfy the second procedural requirement.

- Third, minutes must be kept of each meeting at which compensation is considered or approved. The minutes must reflect: (i) the terms and conditions of the compensation arrangement at issue; (ii) the members of the board (or committee) who participated in the debate and/or approval of the arrangement and the vote taken; (iii) the objective criteria relied on and the rationale of the board (or committee) in determining that the objective criteria supported the reasonableness of the arrangement; and (iv) the identity of any member of the board (or committee) who had a conflict of interest that prevented participation in the process.

  The EDFUND Policy requires that each meeting of the Board, the Executive Committee and PEN Committee at which compensation is discussed or approved be documented by minutes reflecting the decisions made, members present, nature and source of data or other information considered, and rationale(s) for decisions made. However, the regulations require that the meeting minutes also reflect the identity of each person who voted on the matter. While this requirement is arguably present in the provisions of the EDFUND Policy requiring the minutes to reflect "the decisions made" and "members present," it would be better to specifically require that voting results be stated. In addition, the regulations require that minutes of a board (or

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committee) meeting must be prepared before the next meeting of the board (or committee) or, if later, 60 days after the meeting. This timing requirement should be added to the EDFUND Policy.

b. Additional Issues Relevant to Incentive Compensation. Incentive compensation arrangements raise issues under the "private inurement" and "private benefit" doctrines in addition to reasonableness. Such additional issues arise out of the case law, statutes and regulations, but have primarily been shaped by IRS interpretations. In its *Continuing Professional Education Technical Instruction Program for FY 2000*, the IRS reviewed and summarized this law in the context of incentive compensation arrangements for physicians. The principles discussed apply to any IRC Section 501(c)(3) organization. The IRS identified 13 relevant factors in its *Instruction Program*. However, these may be distilled into three broad principles:

- First, incentive compensation arrangements that motivate behavior that conflicts with the achievement of exempt purposes violate the proscription against private benefit. For example, incentive compensation arrangements that place undo focus on the bottom line may well result in decisions to cut back or reduce the delivery of exempt services, or to reduce operating expenses in ways that impair the quality of services provided, all in conflict with the achievement of broad public benefit. To avoid undo focus on the bottom line, the IRS requires that fiscal measures be accompanied in incentive compensation arrangements by other measures that reflect directly on the achievement of exempt purposes.

  Although specific incentive goals have not yet been adopted, both Policies provide for the adoption of performance goals that further EDFUND's exempt purposes.[1] Provided that the performance goals actually adopted measure not only financial performance but also quality measures, such as loan guarantee volume, market share, customer feedback, default rate, employee turnover rate, etc., this requirement will be satisfied.

- Second, an individual who stands to benefit from an award of incentive compensation based on the achievement of one or more performance goals must have some meaningful influence or control over their achievement. If the individual has such influence or control, then the incentive compensation may be justified as additional compensation paid for a job well done. If the individual lacks such influence or

[1] The CSAC Policy prescribes the adoption of goals "that support the organization's mission and strategic objectives," and that are "aligned with the goals of the organization." To cite a few examples, the EDFUND Policy similarly states a general purpose of establishing compensation programs that "reflect and perpetuate the mission of our organization," and that encourage "superior customer service," and the "continued maximization of benefits to the borrower."

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control, then the payment lacks a service connection and assumes more of the feel of a profit distribution in violation of the private inurement doctrine.

The EDFUND Policy provides in this regard that "Participants should have authority, influence and/or control over individual goal achievement." Again, provided that the terms of the EDFUND Policy are observed in establishing specific incentive compensation goals, this principle should be satisfied.

- Third, because incentive compensation is inherently indefinite in amount at the time an incentive compensation arrangement is established, the IRS takes the position that incentive compensation arrangements should incorporate a "cap" or maximum amount as assurance that, regardless of what happens, there will be no unreasonable compensation windfalls.

  Here, the Policies do not contain a cap. Nonetheless, the Policies do require that a determination of reasonableness be made not only when a compensation package is adopted, but also when specific amounts of incentive compensation are determined. This "second look" at the actual amount of an incentive compensation award serves the same purpose as a cap – namely, assuring that an incentive formula does not result in any unanticipated and unreasonable compensation windfalls. Accordingly, we believe that this second look serves as an adequate substitute for a cap. Nonetheless, in the event of an examination, the IRS is likely to question the lack of a cap.

* * * * *

We are hopeful that this letter sufficiently responds to your request. In the event you would like us to address other issues, however, or if you would like to discuss any of the issues addressed herein in further detail, please do not hesitate to contact us.

This letter is solely for your benefit and may not be relied on by any other person without our prior written consent. This letter is based on the law as it exists on the date hereof. Such law is subject to change at any time, and any such change may materially affect the conclusions set forth above. We expressly disclaim any responsibility to update this letter in the event of any such changes in the law.

Very truly yours,

Mark T. Schieble

EDFUND

EXECUTIVE COMPENSATION POLICY

I. POLICY STATEMENT

EDFUND is a loan services auxiliary with a national presence and clientele, operating as the non-profit auxiliary of a State agency. EDFUND'S policy is to provide to its executives direct compensation programs and potential earnings opportunities that reflect and perpetuate the mission of the organization: ***maximizing benefits to borrowers by being the premier service provider in the student loan industry.*** To encourage superior customer service, profitable growth and operating performance, as well as continued maximization of benefits to borrowers, EDFUND'S pay and incentive programs will reward both individual and organization performance which emphasizes these goals and results. Programs are designed to:

- Attract, retain, and motivate highly qualified executives to achieve mission-critical outcomes.
- Provide overall compensation and benefit opportunities consistent with reasonable, market-based pay packages.
- Support the organization's mission and strategic objectives by aligning rewards with accomplishing those objectives;
- Provide appropriate rewards for superior organization and individual performance and skills.

To implement these policy guidelines, EDFUND generally recruits executive talent from both non-profit and for-profit financial services organizations.

This policy applies to the review, establishment and administration of all cash and non-cash compensation policies and programs and major changes in EDFUND'S benefit plans that are applicable to the President and the members of the Executive Management Team as well as any other individual or groups the Board of Directors deems appropriate, based upon its interpretation (as guided by EDFUND'S Legal Counsel) of the definition of "disqualified persons" in Section 4958 of the Internal Revenue Code of 1986. It is EDFUND'S intention to perform its duties in a manner that will establish a presumption that the total remuneration packages offered to the President, the Executive Management Team, and other "disqualified persons" are reasonable.

II. EXECUTIVE COMPENSATION PROGRAMS

Base Salary Program

The objective of the base salary program is to provide a market-based program for functionally comparable positions. EDFUND'S positioning for base salary will consider:

- Organizational need and the identification of exceptional talent in cases warranting above-market positioning;
- The individual's performance, skill set and experience as well as the position's relationship to market data;

- Possible adjustment annually and positioning within the reasonable market range;
- A range generally within ten percent of the median or 75th percentile ranges of comparable positions, adjusted to reflect scope, functionality and complexity.

Annual Incentive Plan (AIP)

The objective of the AIP is to reward the successful achievement of the organization's annual strategic business goals and to provide competitive variable compensation opportunities. The AIP should balance both financial and individual goals and:

- Participants should have authority, influence and/or control over individual goal achievement;
- Plan payments should be reasonable and commensurate with individual performance and company affordability and be aligned with comparable market opportunities;
- There is a requirement that a positive operating margin for the loan program be a threshold for payment of any award and be consistent with the CSAC Policy Statement and Guidelines on EDFUND Incentive Compensation Plans;
- The recommendation and payment of any annual incentive amount will consider both the organization's and the individual's performance and will be within a reasonable market range given the contribution of the individual and organizational results as well as the value of the total compensation package.
- The benchmark and cap on executive annual incentive compensation is set at twenty percent of annual base salary of the participants. In calculating the actual individual incentive compensation amounts:

  (A) Seventy-five percent (fifteen percent of annual base salary) shall be based on the company's overall performance score consistent with the goals adopted in the annual business plan, and
  (B) Twenty-five percent (five percent of annual base salary) shall be based on individual performance.

Benefit Plans

EDFUND'S Executive Benefit Plans will reflect what is typical practice among similar organizations and be targeted to provide market median levels of compensation. The objective of benefit plans is to assist in the long-term well being and retention of employees and includes:

- Health and Welfare plans which are provided to protect and care for employees and their families under certain circumstances;
- Executive Retirement plans (including qualified and supplemental plans) which provide a total retirement package to senior level executives that targets between the median and 75th percentiles of typical market practice, with an emphasis on long-term employment and wealth accumulation;
- Supplemental Benefits which will not be emphasized and will be provided only if prevalent and significant for attracting and retaining executive talent.
- Perquisites, per se, which will not be provided. An automobile allowance is provided to the President consistent with typical market practice.

- Other Policies, including relocation and severance if utilized, which will be targeted at market median.
- Relocation policies will be designed to provide reasonable short-term assistance to new or transferring employees relocating from one area to another, as a recruiting tool, consistent with competitive practice.
- Severance benefits will be considered on a case by case basis, given the facts and circumstances of an individual's role, performance and situation in accordance with the provisions of the EDFUND Severance Policy. Any variance from the company's severance policy must have advance written approval from the Board of Directors or a committee to whom the Board delegates this role.
- EDFUND does not provide loans to its executives.

Employment Contracts

Generally EDFUND does not utilize employment contracts for its executives. If deemed appropriate, EDFUND may negotiate employment contracts on an as-needed basis, approved by the Board of Directors and only at the most senior and/or critical levels of the organization. Terms in the contract will conform to, as much as practicable, EDFUND'S standard policies.

Impact of Section 4958 of the Internal Revenue Code

EDFUND, through its governing bodies (PEN Committee, Executive Committee and Board of Directors) shall make every effort to establish a presumption that the total remuneration packages provided to its President and Executive Management Team are reasonable, as such presumption is contemplated in Section 4958 of the Internal Revenue Code of 1986, as amended from time to time.

III. RESPONSIBLE BODIES

Three EDFUND bodies have responsibilities in carrying out EDFUND'S Executive Compensation Policy. In addition, the President's incentive compensation amount and the total incentive compensation pool amount for the Executive Management Team are referred to the Executive Director and Chair of the Student Aid Commission.

The **EDFUND PEN Committee** is responsible for assessing the market for reasonable, comparable and appropriate data with which to compare each executive's total compensation package. The EDFUND PEN Committee ***provides its assessment*** to the EDFUND Executive Committee.

The **EDFUND Executive Committee** reviews and considers the market assessment, along with related information on organizational and individual performance, and ***provides its recommendation*** as to pay actions and awards for each executive to the EDFUND Board of Directors. The EDFUND Executive Committee recommends executive pay actions and policies/programs, or changes thereof, with respect to any payment or program that impacts the executive compensation package for disqualified persons.

The **EDFUND Board of Directors** has the authority to ***approve*** the recommendations of any element, change or payment related to executive pay packages.

The **Commission Executive Director** has the responsibility of reporting to the Commission Chair his/her recommendation on the overall performance of EDFUND and the assessment of the individual performance of EDFUND'S President. Additionally, the Commission Executive Director will report his/her recommendation on the annual incentive compensation amount to be paid to the President and the total annual incentive compensation pool to be allocated among the Executive Management Team.

The **Commission Chair** is responsible for concurring with or modifying the overall performance of EDFUND and the incentive compensation amount approved by the EDFUND Board of Directors for the President as well as the total annual incentive compensation pool amount to be allocated among the Executive Management Team.

IV. INDEPENDENCE

All members of the EDFUND Board of Directors, EDFUND Executive Committee and EDFUND PEN Committee, as well as the Commission Executive Director and Chair shall be independent and have no conflicts of interest, as defined in Internal Revenue Code Section 4958. A member of the authorized body does not have a conflict of interest with respect to a compensation arrangement or property transfer only if the member:

(A) Is not a disqualified person participating in or economically benefiting from the compensation arrangement or property transfer, and is not a member of the family of any such disqualified person, as described in section 4958(f)(4) or §53.4958-3(b)(1);
(B) Is not in an employment relationship subject to the direction or control of any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer;
(C) Does not receive compensation or other payments subject to approval by any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer;
(D) Has no material financial interest affected by the compensation arrangement or property transfer; and
(E) Does not approve a transaction providing economic benefits to any disqualified person participating in the compensation arrangement or property transfer, who in turn has approved or will approve a transaction providing economic benefits to the member.

All independent members will complete a statement of independence at least annually, which will be reviewed by EDFUND'S Legal Counsel.

V. ROLES AND RESPONSIBILITIES

Each EDFUND entity will carry out this policy in the following manner:

A. EDFUND *PEN Committee*

To determine the relevant market data for each position within the Executive Management Team, the EDFUND PEN Committee obtains and reviews reliable and comparable data from a select peer group of not-for-profit student loan operations with an emphasis on revenue, budget, complexity and mission. EDFUND'S revenue and budget will approximate the median for the select group. The peer group data will be supplemented by published survey data from a recognized, independent source representing similarly-sized, not-for-profit and for-profit financial services organizations. EDFUND will assign a weighting to the different sources to reflect the appropriate market for talent for functionally comparable positions within the loan servicing industry as follows:

Peer Group	50%
Not-for-Profit Financial Services Organizations (survey)	25%
For-Profit Financial Services Organizations (survey)	25%

This weighting may be revised from time to time based on the determination of the PEN Committee. The rationale for any such revisions will be documented in the minutes of the PEN Committee's meetings.

To determine the appropriate market levels for comparison and to assess each incumbent executive accordingly, total compensation ranges will be created based on the appropriate market data sources for base salary, total cash compensation (base salary plus annual incentives), total retirement, supplemental benefits and perquisites and total compensation (combination of all elements). The incumbent's current compensation package will be presented for comparison purposes against these comparable ranges for both the median and 75th percentiles of the comparable market data. A summary of the analysis will be provided to the EDFUND Executive Committee for each individual executive.

B. EDFUND *Executive Committee*

The EDFUND Executive Committee's responsibility is to review the market assessments provided by the PEN Committee along with additional input to create its recommendations for pay actions and policy/program changes. The Executive Committee will seek input from the President and other members of the Executive Management Team as appropriate when assessing pay data. In reviewing the comparable data, organizational performance against budgets and expectations, individual performance objectives or indicators, the financial position of EDFUND and any pertinent facts and circumstances will be considered. In making its recommendations, the Executive Committee will seek proposed changes, as well as performance and other criteria, from EDFUND'S President for each member of the Executive Management Team. The Executive Committee will refer to all applicable Policy statements for elements of total compensation, and will consider the value of the compensation package in its entirety against the comparable data. The Executive Committee will present its recommendation to the Board of Directors for each individual, with related rationale and supporting information.

When establishing annual incentives, the Executive Committee will work with the President and the Executive Management Team as needed to incorporate into the annual incentive program design the objectives and milestones associated with key strategic initiatives. Annually, the Executive Committee will review with the Board of Directors the goals and objectives proposed by the President for EDFUND and the individual objectives for each Executive Management Team member.

The Executive Committee will evaluate the President's performance and the performance of the Executive Management Team in light of the goals established before recommending to the Board of Directors the annual incentive award amount and/or other incentives or benefit. The Executive Committee's evaluation will consider the President's input and the performance of each executive against established quantitative metrics and qualitative assessments.

The Executive Committee is also responsible for developing this policy and reviewing it at least every three years, deciding upon any modifications it deems reasonable, competitive, and equitable, to ensure that the Policy supports the long-term interests of EDFUND and provides a competitive and performance-oriented compensation opportunity for executives managing the organization. The Executive Committee will propose to the Board of Directors any modifications to the philosophy or to the individual plans, programs or policies. The Executive Committee will fully, consistently and faithfully apply the policy in a manner that will establish the presumption that total compensation decisions are reasonable under the provisions of Internal Revenue Code Section 4958 or Intermediate Sanctions.

C. EDFUND Board of Directors

The Board of Directors will review the evaluation, appropriate comparable data and recommendations of the Executive Committee before finalizing any salary, annual incentive award and/or other incentives or benefits decisions for the members of the Executive Management Team. The EDFUND Board of Directors is responsible for approving any cash or non-cash form of executive compensation and benefits as well as each payment accrued or paid. The Board of Directors will fully, consistently and faithfully apply the policy in a manner that will establish the presumption that total compensation decisions are reasonable under the provisions of Internal Revenue Code Section 4958 or Intermediate Sanctions.

The EDFUND Board of Directors will provide the Executive Director and the Chair of the Student Aid Commission with documentation that details the overall performance of EDFUND and an assessment of the individual performance of EDFUND's President. The EDFUND Board will also recommend to the Executive Director and the Chair of the Student Aid Commission the proposed incentive amount for the President and the total incentive compensation pool amount for the Executive Management Team.

D. Commission Executive Director

The Commission Executive Director will review the documentation that details the overall performance of EDFUND, as well as review the assessment of individual performance of the President provided by the EDFUND Board of Directors. The Executive Director will provide his/her recommendation to the Commission Chair as to the annual incentive amount for the President and the total annual incentive pool amount for the Executive Management Team.

E. Commission Chair

The Commission Chair will evaluate the EDFUND Board of Directors' report and the Commission Executive Director's report on the performance of the organization, and the President's individual performance, the annual incentive amount for the President and the total incentive pool amount for the Executive Management Team, and ratify or authorize a modified amount, with rationale for any adjustments. The Commission Chair's decision will be reported to the EDFUND Board of Directors. Any modification that increases incentive compensation amounts shall be returned to the EDFUND Board for determination of reasonableness.

VI. RECORDS AND SUPPORT

Each Committee and the Board of Directors will review, discuss and deliberate the matters under their purview and prepare minutes of each meeting in which executive compensation is discussed. The minutes will reflect the decisions made, members present, nature and source of data or information considered, any explanation or rationale for each decision for each executive, the identity of each person voting on the matter, and the voting results. Preparation of the minutes should be completed prior to the next Board or Committee meeting, but in no event later than sixty (60) days after such Board or Committee meeting.

The EDFUND PEN Committee, EDFUND Executive Committee and the EDFUND Board of Directors shall retain the right to consult and may engage the professional services of independent legal counsel, compensation experts, accountants and other experts and external advisors on matters related to executive compensation policies, practices and market data.

9.c

Action/Information Item

California Student Aid Commission

Consideration of the Operating Agreement between the Commission and EDFUND

The current Operating Agreement is set to expire June 30, 2007. As required by California Education Code section 69522(d), staff provided a copy of the proposed Operating Agreement, as well as the Service Level Agreement, to the Department of Finance (DOF) and the Joint Legislative Budget Committee (JLBC) for their review and comment on May 2, 2007. DOF and JLBC were requested to provide comments to the proposed Operating Agreement no later than June 15, 2007.

Staff received an official response from the Director of the Department of Finance along with questions and concerns sent in a separate email from DOF staff (Tab 9.c.1) and a draft response prepared by the Legislative Analyst's Office for JLBC (Tab 9.c.2), which contained extensive comments that would result in substantial changes to the proposed Operating Agreement and Service Level Agreement.

California Education Code section 69522(d)(2)(a) states that "if the Director of Finance or the Joint Legislative Budget Committee notifies the Commission regarding issues of concern with the proposed Operating Agreement, the Commission shall convene a meeting of appropriate representatives from the Commission, Department of Finance, and the Legislature to resolve those issues." A meeting with staff from CSAC, EDFUND, DOF and JLBC was scheduled for May 18, 2007.

Staff will provide an update regarding the meeting with DOF and JLBC staffs.

The proposed Operating Agreement (Tab 9.c.3) and Service Level Agreement (Tab 9.4) are enclosed for your reference.

Responsible Staff: Janet McDuffie
Chief, Management Services and
Acting Chief, Federal Policy &
Programs

DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

ARNOLD SCHWARZENEGGER, GOVERNOR
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June 6, 2007

Ms. Diana Fuentes-Michelle
Executive Director
California Student Aid Commission
P.O. Box 419026
Rancho Cordova, CA 95741-9026

Dear Ms. Fuentes-Michelle:

This letter is in response to your May 2, 2007 request to review the proposed new Operating Agreement (Agreement) between the California Student Aid Commission (Commission) and its auxiliary organization, EdFund, that is proposed to be effective for five years commencing July 1, 2007.

As you are aware, subdivision (d) of Education Code Section 69522 requires both Finance and the Joint Legislative Budget Committee to review and comment on any new agreement, or any amendment to the existing agreement, within 45 days of submission and for the Commission to convene a meeting of appropriate representatives of Finance and the Legislature to resolve any issues of concern that are identified.

The Department of Finance has completed an initial review of the proposed new agreement and notes the following areas of concern:

The Operating Agreement is Not Complete

The Agreement submitted for approval does not contain definitive policies necessary to determine operating rules for EdFund nor an annual expenditure level. Basically, it specifies that an assortment of policy and operational goals will be determined in subsequent documents subject to the approval of the Commission. Noteworthy items that came under question in the recent Bureau of State Audits (BSA) Report have been omitted and include:

- Service level goals relating to the Federal Family Education Loan Program (FFEL) guaranty function
- Travel policy for EdFund staff and executives
- Investment policy for funds under the control of EdFund
- Executive pay incentives and staff bonuses

It is also noted that a definitive operating budget is not included for the next fiscal period. Rather, the Agreement includes a timeline for development and approval of the operating budget. As such, the proposed Agreement is more of an outline for a process to agree on operating policy, service level goals and an expenditure plan than an inclusive operating agreement for the upcoming federal fiscal year. The Department of Finance believes the Agreement should include all provisions relevant for the upcoming fiscal period including a specific service level agreement and operating budget.

No Oversight Policy is Specified in the Operating Agreement

The Agreement does not contain specific oversight rules that would clear up the "lack of cooperation" and "poor oversight" issues that have been of concern and noted in the BSA audit. With respect to the role of the Commission staff in analyzing a proposed annual EdFund budget and reviewing changes mid-year, the document is notably deficient. We believe that part-time Commissioners are ill equipped to make a detailed analysis of revenue projections and expenditure needs without the benefit of full-time staff, detached from EdFund, to advise the Commission of potential issues, faulty assumptions, and to ensure adequate justification for staffing levels compared to whatever operating goals are agreed to.

Control of the Equity Account is Not Resolved

The Agreement does not resolve the issue of who controls the Equity Account nor for what purposes these funds may be spent. This money has been described to us as under the control of EdFund to implement technology changes or diversification activities, yet we are informed that this account reflects funds available in the Student Loan Operating Fund (SLOF) reserve. We believe, especially in light of a proposed sale of the guarantee function, that the $26.3 million of state funds currently included in this account should be returned to the SLOF fund balance where it can only be expended upon approval of the Commission and with the concurrence of the Legislature and the Administration.

There is No Opportunity for Policy Makers to Review Expenditures of State Funds for Non-FFEL Operating Expenses

The Commission has not included any provision to seek the concurrence of either the Legislature or the Administration for various expenditures that are not directly connected to operating the FFEL loan guaranty program. The Agreement should limit the EdFund's expenditures through the continuous appropriation authority provided under subdivision (d) of Section 69766 of the Education Code to only those necessary to operate the FFEL program. Any major investment in local assistance, state assets, or outreach and awareness programs that are not directly related to FFEL guaranty business operations should be subject to annual review through the normal budget process or some other means if the budget process is not timely.

A Five-Year Term of Agreement is Not Desirable Given the Administration's Proposal to Sell the Loan Guaranty Function

Given the proposed sale of EdFund, an operating agreement should be a year-by-year proposition. Additionally, attention should be given to provisions that would ensure a smooth transition to a prospective seller so as not to unduly disrupt the grant functions administered by the Commission given the many shared operations and infrastructure that support the grant program but are housed and operated by EdFund under charge-back agreements.

A more detailed list of comments and questions, keyed to the Agreement's provisions, has been forwarded to you. As you are aware, the Commission already extended the term of the existing agreement twice and the Joint Legislative Budget Committee has expressed concerns with any additional extension. We understand it will present a challenge to complete all of the operating goals and policies prior to expiration of the existing agreement. Therefore, we remain open to an approach that will address these concerns in the most timely manner.

Should you have any questions or wish to convene a meeting with appropriate parties to discuss the resolution of these concerns, please do not hesitate to contact Jeannie Oropeza, Program Budget Manager, or Lynn Podesto, Assistant Program Budget Manager, at (916) 445-0328.

Sincerely,

Fred Klass

for MICHAEL C. GENEST
Director

cc: Honorable Denise Moreno Ducheny, Chair, Joint Legislative Budget Committee
Mr. Sam Kipp, President, EdFund
Mr. Steve Boilard, Director, Legislative Analyst Office
Ms. Janet McDuffie, Chief of Management Services, Student Aid Commission
Dr. David Long, Secretary, Office of the Secretary for Education

icc: GENEST, BROWN, SHEEHAN, KLASS, ARNOLD, FINN, OROPEZA, PODESTO, SWAN, LEAHY

Specific Operating Agreement Questions and Comments

Article 1--Term of Agreement:

1.1 Proposes five-year term whereas old agreement was for one-year at a time. A five-year term is not advisable given proposed sale. One year agreement, as in the past, is more appropriate.

Article IV--Ed Fund's Agreements:

4.5 Should consider opportunity for Commission to approve written Ed Fund policies rather than review after the fact.

4.6 Provides only one month before FFY begins for Commission to approve Ed Fund Budget. No mention of CSAC staff role to review budget and provide perspective for Commission to consider in adopting Ed Fund budget.

4.8 Why is there a qualifier to the agreement that all of EdFund's assets are held for the benefit of CSAC (e.g. "to the extent provided in the EdFund Articles of Incorporation")? What assets are exempted—does this refer to Equity Account and advance funding?

Article V--Commission/CSAC Agreements:

5.1 Should this be revised to reflect the possibility of a sale of EdFund and the guarantee function to another entity?. As written, would it create problems under a sale?

Article VI—FFEL Program Funds, Payments to Ed Fund and /or CSAC:

6.2. Why is the definition of a shortfall in the SLOF expressed as one-year's expenditure of <u>CSAC's "grant administrative expenses as appropriated by the state budget process"?</u> There is no relation between the Ed Fund operating budget and the Commission's state operations budget.

Also, this section clarifies that cash in "all accounts" shall be used by Ed Fund when cash flow is marginal (veiled reference to Equity Account). We are concerned that this agreement does not resolve that the Equity Account be terminated and returned to the balance of the SLOF.

6.3 Incentive Compensation Plans are authorized pursuant to policies adopted by Commission but are not included in this submission for review. Why not? Why should those policies vary and not be a permanent part of agreement?

6.4 Investment of Ed Fund cash, including advances, are authorized to be invested according to policy approved by Commission but are not included in this submission for review. Why not? Why should those policies vary and not be a permanent part of agreement?

6.5 Travel Expenses are authorized to be reimbursed pursuant to policy approved by Commission but are not included in this submission for review. Why not? Why should those policies vary and not be a permanent part of agreement?

Article VII—Effective Date, Assignment and Termination:

7.1 Conforming to term of agreement in Article 1—same issue as Article 1.1

Article VIII—Oversight

8.2 This section specifies annual audits of EdFund. There is a lack of specificity as to who shall contract for the various audits conducted by an independent CPA.. DOF prefers that CSAC retain the right to determine who selects the independent audit firms.

Also, it does not appear that a "performance audit" is addressed as in prior agreements". Is that form of audit addressed in subdivision H related to other Audits and Evaluations? If not, why not? Aren't the annual performance goals the essence of the agreement between the Ed Fund and the CSAC with respect to bonuses and incentives? How else would disputes on performance be addressed if performance is subject to debate?

8.6 This section specifies the "Annual Oversight Plan". This section merely specifies timeframes for adoption of a plan by the CSAC division assigned to EdFund to develop an annual oversight plan but does not include a specific plan or its required components. Where is the plan and why is annual oversight something that should not be included in the plan? What circumstances exist that make annual oversight not amenable to becoming a permanent part of the agreement?

This is the fundamental issue we would have expected to be detailed in order to resolve disputes between Ed Fund and CSAC; yet it is not addressed in this submission for DOF comment and, thus, appears to be a major omission of the proposed operating agreement.

Article IX—General Provisions

9.15 This section defines a new dispute resolution process that includes processes for resolution as an alternative to "binding arbitration" per the current agreement. As such it seems reasonable to attempt mitigation of disagreements by less formal and legalistic means.

Service Level Agreement—This is a separate document from the Operating Agreement intended to specify the services that are to be performed by CSAC and EdFund in connection with the Operating Agreement.
Section 1—specifies EdFund's FFEL program operational, support, and administrative services, but does not define service levels expected.
Section 2—specifies other support services EdFund provides on a reimbursement basis to the Commission. It is not exhaustive and may be added to as an amendment. Includes supply services, report distribution, mail processing, printing and copying, security of facilities, warehouse and shipping, vehicle maintenance, records retention, shared conference and storage rooms, technology including data center support and phone systems, training of staff and clients on grants, inventory records, and other services such as publications and video production, software development and research.
Section 3—specifies numerous reports to be provided by EdFund to CSAC for a variety of items in Section 1 and 2 and others.
Section 4—specifies reports to be provided by CSAC to EdFund on a variety of matters including personnel and benefit information for civil service staff for budgeting purposes,

accounting documents for financial statements, and FASFAs received by CSAC for grant program
Section 5—specifies that Performance Expectations annually will be agreed upon by July 31, 2007 covering the areas of service expected of EdFund.

Issues on Service Level Agreement:

Section 1—Why are there no specific level goals in this document?
Section 1—Item 10 specifies among other things that Ed fund shall advocate legislative and regulatory positions as directed by the Commission, but does not indicate those directions take place in the form of official Commission action at a public meeting. Why not? Shouldn't advocacy efforts be subject to public scrutiny?

Section 1—Item 11 specifies among other technology services that Ed Fund design, develop, and implement new technology to enhance current services, but does not require a specific business case be made for this function. Why not? What other policies would control how much can be spent on systems for "enhancements" beyond meeting FFEL program requirements?

CHAIR
DENISE MORENO DUCHENY

VICE CHAIR
JOHN LAIRD

SENATE

DAVE COGDILL
DENNIS HOLLINGSWORTH
CHRISTINE KEHOE
BOB MARGETT
ALEX PADILLA
JACK SCOTT
TOM TORLAKSON

ASSEMBLY

JULIA BROWNLEY
ANNA CABALLERO
MICHAEL DUVALL
MARK LENO
ROGER NIELLO
LAURA RICHARDSON
MIMI WALTERS

June 7, 2007

Ms. Diana Fuentes-Michel
California Student Aid Commission
P.O. Box 419026
Rancho Cordova, California 95741-9026

Dear Ms. Fuentes-Michel:

On May 2, 2007, you submitted a new operating agreement between the California Student Aid Commission (CSAC) and EdFund, in accordance with Education Code Section 69522(d).

The Legislative Analyst advises me that your proposed operating agreement does not meaningfully address the operational and oversight issues that have been of concern to the Legislature. Instead, the draft agreement largely defers resolution of these issues to side agreements and working groups that are not subject to review by the Legislature. For example, the draft operating agreement defers resolution of a central, contentious issue about oversight of EdFund activities to an "annual oversight plan" that the commission is to develop "in consultation with EdFund staff." Similarly, the draft agreement relegates to a "service level agreement" the setting of goals for EdFund's performance. These are exactly the type of issues that should have been resolved and incorporated into the draft operating agreement.

The Legislative Analyst further advises me that the commission's failure to address these issues in its draft operating agreement stems in part from an inability to define the respective roles and responsibilities of the commission and EdFund. You will recall that you assured me in your December 2006 letter that the new operating agreement would include revised roles and responsibilities. Nevertheless, you have now submitted your draft operating agreement without adopting a new "Roles and Responsibilities" agreement.

As you know, the Governor's May Revision includes a proposal to sell EdFund and relinquish CSAC's role as the designated state guarantor for the Federal Family Education Loan Program (FFELP). Even if this proposal is part of the enacted budget for 2007-08, selling EdFund will involve a number of complicated, technical issues and negotiations with potential buyers and the U.S. Department of Education. Until all these issues are resolved and a sale, if any, is effectuated, the state is obligated to carry out its loan guarantee function. Given the uncertainty surrounding EdFund, as well as major changes to the FFELP currently under consideration by Congress, I do not think it is prudent for the new operating agreement to run for five years, as you propose. Rather, I believe that a one-year term would ensure the agreement is reevaluated in another year, when the status of EdFund and the FFELP should be clearer.

In summary, the proposed operating agreement does not do what the commission pledged to accomplish. As such, I cannot concur with the proposed draft agreement. I expect that you will address these concerns within the time frame you promised in your December 2006 letter to me.

Sincerely,

Denise Moreno Ducheny
Chair

cc: Members of the Joint Legislative Budget Committee

OPERATING AGREEMENT

This Agreement is effective the first day of July 2007, between the California Student Aid Commission (CSAC), a public agency of the State of California and EDFUND, a nonprofit public benefit corporation organized under the laws of the State of California.

ARTICLE I
Term

1.1 Term. The term of this Agreement shall be for a 5-year period from the effective date, unless sooner terminated under Article VII.

ARTICLE II
Definitions

2.1 Definitions. In this Agreement, the following words and terms shall have the following meanings:

A. "Agreement" is the Operating Agreement between the California Student Aid Commission and EDFUND.

B. "California Student Aid Commission" or "CSAC" is the primary State agency responsible for the administration of state-aid programs, key among them the Cal Grant Program. CSAC is also the designated State guaranty agency responsible for the Federal Family Education Loan (FFEL) Program. For purposes of this definition CSAC does not include EDFUND.

C. "Commission" is the governing body of the California Student Aid Commission.

D. "EDFUND" is the auxiliary corporation of the California Student Aid Commission, founded on January 1, 1997, as a nonprofit 501(c)(3) public benefit corporation.

E. "EDFUND Board of Directors" or the "EDFUND Board" is the governing body of EDFUND.

F. "FFEL Program" is the Federal Family Education Loan Program.

G. "SLA" is a service level agreement(s) that defines the parameters of the services between CSAC and EDFUND.

ARTICLE III
FFEL Program and Governance Policies

The Commission is responsible for developing and approving policies for the governance of the FFEL Program. Nothing in this Agreement, SLA or any policy shall be construed as delegating to EDFUND the Commission's fiduciary responsibilities as required under California statute. EDFUND shall provide research and policy analysis and make policy recommendations to the Commission, as appropriate or as requested by the Commission. CSAC and EDFUND staff and the EDFUND Board shall adhere to all FFEL Program policies adopted by the Commission, provided that the policies are consistent with this Agreement.

ARTICLE IV
EDFUND's Agreements

4.1 Status as Auxiliary. EDFUND agrees to be the auxiliary organization of CSAC and operate as a nonprofit public benefit corporation in good standing under California law. EDFUND further agrees to maintain its tax-exempt status under Section 501(c)(3) of the Internal Revenue Code.

4.2 Scope of Services. EDFUND agrees to provide CSAC with data and services pursuant to this Agreement and SLA. EDFUND further agrees not to engage in any activities, services or corporate actions outside the scope of services agreed to herein without approval of the Commission.

A. FFEL Program Services. EDFUND agrees to perform such operational, support and administrative services, as agreed to by the Commission and the EDFUND Board, for the benefit of CSAC in its role as guarantor under the FFEL Program. Services are to be provided pursuant to this Agreement and SLA.

B. Other Services. EDFUND agrees to perform such other operational and support services pursuant to an SLA and as permitted by law.

4.3 Processing System. EDFUND agrees to maintain a financial aid processing system that is auditable for all identified program transactions.

4.4 Compliance. EDFUND agrees to perform all services as agreed to by the Commission and the EDFUND Board in full compliance with applicable State law and the Higher Education Act of 1965, as amended, and the regulations from time to time promulgated thereunder. EDFUND further agrees to perform all services as agreed to by the Commission and the EDFUND Board pursuant to Commission policies and pertaining to the FFEL Program, this Agreement and SLA.

4.5 EDFUND Policies. EDFUND agrees to develop, implement and maintain written policies and procedures as are necessary for EDFUND to fully comply with this Agreement and SLA. Proposed policies having a potential material effect on the Operating Fund (see Section 6.1) shall be submitted to the Commission and the EDFUND Board for review and comments. The Commission recognizes the EDFUND Board of Directors' responsibilities to make business decisions pursuant to the California Corporations Code; however, EDFUND policies and procedures shall be available for review by the Commission.

EDFUND agrees to submit any new or revised policy to a designated individual on the CSAC staff and/or such other individual(s) identified by the Commission within ten (10) days of such policy's adoption.

4.6 Annual Loan Program Business Plan, Budget and Goals. EDFUND shall develop an annual Loan Program Business Plan, Budget and Goals for the administration of the FFEL Program that ensures the fiscal viability and continued success of such program. EDFUND agrees to provide a high level conceptual presentation for CSAC staff and/or such other individual(s) identified by the Commission on the annual Loan Program Business Plan, Budget and Goals no later than the fifteenth day of May of each year and prior to any significant document development. EDFUND agrees to make a presentation to the Commission at its June Commission meeting of each year on the current draft of the annual goals for the following federal fiscal year. The Commission and the EDFUND Board will discuss the annual Loan Program Business Plan, Budget and Goals at the Joint Commission and EDFUND Board Workshop held each July. EDFUND agrees to consult with CSAC staff and/or such other individual(s) identified by the Commission on the annual Loan Program Business Plan, Budget and Goals no later than the fifteenth day of July of each year and provide any requested information associated therewith. The EDFUND Board shall approve the annual Loan Program Business Plan, Budget and Goals no later than the thirty-first day of August of each year and submit such documents to the Commission by the first day of September of each year, for review and approval. Such dates may be altered by mutual agreement between the Commission and the EDFUND Board. Any significant change in strategy by EDFUND, following any of the above referenced meetings, shall be communicated to CSAC staff and/or such other individual(s) identified by the Commission.

The annual business plan shall include a description of business objectives EDFUND plans to pursue, its information technology strategies, descriptions of proposed new products or services, descriptions of proposed material changes in EDFUND's operations and the anticipated results of the plan. If the approved business plan changes the services to be provided by EDFUND, the SLA shall be amended to reflect the change in EDFUND services.

The annual budget shall include all projected revenues and expenses expected to be incurred in operations connected with the business plan. The budget shall also include a five-year projection of revenues and expenditures. Any material expenditure of funds or material change in operations or corporate policies outside of the annual Loan Program Business Plan, Budget and Goals shall be submitted to the Commission and EDFUND Board for review and approval.

The annual goals shall include specific, measurable goals and implementation strategies for activities within the FFEL Program for which EDFUND has a reasonable but not an easy ability to accomplish given current industry and regulatory trends, and shall be consistent with the Commission's General Goals. The Commission's General Goals for EDFUND are:

A. Provide premier customer service to schools, lenders and borrowers that meets or exceeds that of EDFUND's competitors.

B. Provide a reliable and sustainable revenue stream to ensure the continuation of a strong competitive loan program and to provide resources, where feasible, for the other priorities established by the Commission.

C. Provide the most efficient and effective service while controlling company costs.

D. Increase California and national loan volumes.

E. Provide a range of products that meet the needs of schools, lenders and borrowers.

F. Continuously invest in the development of technology solutions that enhance the effectiveness and efficiency of both customers and the company.

G. Be a source of public outreach and information to allow students to achieve their educational goals.

H. Provide effective and responsive default aversion programs.

I. Provide administrative, technical and programmatic support to CSAC in accordance with detailed support plans mutually developed and agreed to by both organizations.

4.7 Service Level Agreement. As part of the annual budget process, CSAC and EDFUND shall review the SLA and determine if amendments are necessary.

4.8 Assets. EDFUND agrees and acknowledges that all of its assets, whether owned by EDFUND or in its control, are held for the benefit of CSAC to the extent provided in the EDFUND Articles of Incorporation. EDFUND agrees to manage such assets with the same duty of care as if the assets were owned by EDFUND, and to use and administer such assets only for purposes allowed herein and in conformance with State law. The Commission agrees to adopt a policy to provide an efficient, reasonable and cost-effective procedure for the disposal of EDFUND physical property with a de minimis value or located out-of-state, provided that such policy does not violate State law.

4.9 Civil Service Employees. EDFUND agrees to continue to take the assignment of existing civil service employees of CSAC assigned to EDFUND as of October 1, 1999, as permitted by law, for the purpose of performing services under this Agreement. EDFUND agrees that it shall treat the identified civil service employees as its own employees, except as required due to their civil service status, including terms and conditions of any applicable memoranda of understanding covering represented employees. EDFUND further agrees that for the assigned civil servants who wish to retain their civil service status, it will use its best efforts to make promotional opportunities available to civil service employees on the same basis as at-will employees. EDFUND and CSAC understand that such promotional opportunities are subject to the applicable personnel rules of the State of California.

EDFUND agrees to work with CSAC to provide one day of annual supervisory training to any EDFUND employee who supervises a civil service employee. Such training shall include, but is not limited to, areas of progressive discipline, documentation, attendance, work performance, and any other areas deemed necessary. CSAC civil service employees will be held accountable for their performance and attendance through their managers.

4.10 Insurance. EDFUND agrees to maintain in force during the term of this Agreement insurance as follows:

A. GENERAL LIABILITY INSURANCE, including fidelity coverage, with limits of liability for each occurrence of not less than $5,000,000 for bodily injury and property liability combined.

B. WORKERS COMPENSATION INSURANCE with limits as required by law.

C. DIRECTORS AND OFFICERS INSURANCE with coverage of not less than $5,000,000 per claim with a $5,000,000 annual aggregate limit.

D. AUTOMOBILE LIABILITY for liability arising out of automobiles owned, leased, hired or borrowed by or on behalf of EDFUND, with limits of $1,000,000 per accident for bodily and property damage.

The above insurance limits are the minimum amounts for the described policies and shall be adjusted as necessary to assure sufficient coverage. All such applicable policy(ies) of insurance shall contain a special endorsement naming as a covered entity "The State of California, Student Aid Commission."

ARTICLE V
Commission/CSAC Agreements

5.1 Status as Guarantor. CSAC will remain a guaranty agency for purposes of the Higher Education Act of 1965, as amended, and shall comply with all applicable laws and regulations thereunder, unless the guaranty designation is transferred by the U.S. Secretary of Education or terminated by the State or federal government. The Commission further agrees to maintain EDFUND as its auxiliary organization.

5.2 Compliance with FFEL Program Requirements. The Commission agrees to perform all guarantee services not otherwise assigned to EDFUND in full compliance with the Higher Education Act of 1965, as amended, and the regulations from time to time promulgated thereunder.

5.3 Annual Loan Program Business Plan, Budget and Goals Approval. The Commission agrees to review and approve EDFUND's annual Loan Program Business Plan, Budget and Goals no later than the thirtieth day of September of each year. To the extent that changes are required in the approved annual Loan Program Business Plan, Budget and Goals due to Commission requirements, changes in state or federal law, or other circumstances beyond EDFUND's control, the Commission agrees to negotiate in good faith the annual Loan Program Business Plan, Budget and Goals to reflect such changes.

5.4 Scope of Services. The Commission agrees to provide EDFUND with data and services pursuant to this Agreement and SLA.

5.5 Review and Approvals. The Commission agrees to review any other requests and items within the scope of this Agreement and provide approvals in a timely manner.

ARTICLE VI
FFEL Program Funds, Payments to EDFUND and/or CSAC

6.1 FFEL Program Funds. CSAC, as guarantor, shall maintain the Student Loan Operating Fund (hereinafter known as the Operating Fund) and the Federal Student Loan Reserve Fund (hereinafter known as the Federal Fund) as required by the FFEL Program. As permitted by State and federal law, the Operating Fund may be used for other purposes determined by the Commission and/or the State. CSAC will use the Operating Fund to reimburse EDFUND for its expenses. Revenues received by EDFUND on behalf of CSAC shall be remitted pursuant to agreed upon written procedures. The Operating Fund and the Federal Fund shall be in the sole control of CSAC. EDFUND acknowledges it has no ownership rights to the Operating Fund and/or Federal Fund.

6.2 Reimbursement of EDFUND Expenses. CSAC agrees to pay to EDFUND reimbursement for all monies expended for the provision of services, both guarantee and other, in accordance with EDFUND's approved budget, approved SLA, applicable laws and regulations and other policies established and approved mutually by the EDFUND Board and the Commission. EDFUND shall invoice CSAC for the services provided pursuant to this Agreement and SLA. EDFUND agrees to provide appropriate supporting documentation and, if system security permits, read-only access to the EDFUND accounting system in order for CSAC staff to identify the services rendered. CSAC shall be responsible for reviewing the invoices and approving payments. Payment of invoiced expenses shall be made within 30 days of receipt of all necessary documentation pursuant to this Agreement and SLA. Payment for any disputed expense may be withheld by CSAC and shall be identified in writing to EDFUND within 30 days, including the reason for withholding payment. EDFUND shall have the right to appeal pursuant to Section 9.15. In no event shall the amount reimbursed to EDFUND for guarantee services during the term of this Agreement exceed the total amount budgeted for such services in the operating budget approved pursuant to Section 4.6, unless prior approval for such expenditures was granted by the Commission.

CSAC and EDFUND staffs will work together on Operating Fund and Federal Fund cash flow projections. In the event of a projected cash shortfall in the Student Loan Operating Fund held by the State Treasury, the reimbursement of the EDFUND invoices pursuant to this Agreement may be delayed. A shortfall in the Student Loan Operating Fund held by the State Treasury is defined as less than, or equal to, twelve months of grant administrative expenses as appropriated by the State budget process. Invoice reimbursement may only be delayed so long as EDFUND cash balances are greater than, or equal to, two months of total loan and non-loan operating expenses as presented in the annual Loan Program Business Plan, Budget and Goals as approved by the Commission. EDFUND agrees to utilize available cash in all accounts, as needed, during this cash shortfall period. This delay will in no way compromise the financial viability of EDFUND, pursuant to Section 69526(b)(2) of the California Education Code. If a shortfall exists in both the Student Loan Operating Fund held by the State Treasury and in the EDFUND accounts, the CSAC Executive Director and EDFUND President will collaborate on a prudent course of action. Once sufficient funds are available in the Student Loan Operating Fund held by the State Treasury, delayed reimbursements will be processed as quickly as possible in order to return to the prescribed timeframe detailed above.

6.3 EDFUND Incentive Compensation Plans. Variable Pay Plans and Incentive Compensation Plans are hereby authorized and shall be administered pursuant to policies adopted by the Commission and the EDFUND Board.

6.4 Investment of EDFUND Cash. EDFUND cash, including cash resulting from any advance from the Operating Fund, shall be invested according to a policy approved by the Commission and the EDFUND Board.

6.5 Travel Expenses. All travel expenses incurred by EDFUND shall be reimbursed pursuant to the EDFUND Travel Policy approved by the Commission and the EDFUND Board.

6.6 Reimbursements to CSAC. EDFUND agrees to pay CSAC for services rendered pursuant to this Agreement and SLA.

ARTICLE VII
Effective Date, Assignment and Termination

7.1 Effective Date. This Agreement shall be in full force and effect as of the date first above written and shall continue in full force and effect until June 30, 2012 unless sooner terminated as herein provided. The parties may amend this Agreement for subsequent terms, as allowed by law, by written agreement of both parties prior to the expiration of this Agreement.

7.2 Assignment. This Agreement may not be assigned in whole or in part by either party without the prior written consent of the other party.

7.3 Termination without Cause. The Commission may terminate this Agreement at any time without cause upon 60 days' written notice.

7.4 Termination for Cause. Either party may terminate this Agreement for cause upon 30 days' written notice to the other party specifying the cause and the proposed termination date. For purposes of this Agreement "cause" shall mean:

A. Material breach of this Agreement,

B. The inability by a party to perform in whole or material part any of its obligations hereunder for a period of more than thirty (30) consecutive days, or

C. With respect to termination by the Commission, the filing of a petition in bankruptcy by EDFUND or against EDFUND by someone other than a party to this Agreement.

However, should the party receiving notice of termination for cause cure, in the noticing party's sole judgment, the condition giving rise to such notice before the date specified for termination, then this Agreement shall continue in full force and effect.

In lieu of termination under this Section, the parties may initiate the dispute resolution process in Section 9.15.

7.5 Termination by the Secretary. This Agreement is terminable by the U.S. Secretary of Education upon thirty (30) days' written notice to the parties if the Secretary determines that the Agreement includes an impermissible transfer of federal funds or assets or is otherwise inconsistent with the terms and purposes of Section 422 of the Higher Education Act of 1965, as amended.

7.6 Transfer of Assets. Upon termination of this Agreement and in the absence of a subsequent Operating Agreement between the parties, all of EDFUND's assets, tangible and intangible, shall immediately and without further action by either party become the property of CSAC. EDFUND agrees to take promptly, all steps reasonably requested by the Commission to effectuate such transfer.

ARTICLE VIII
Oversight

8.1 Commission Oversight. As a designated guarantor, the Commission has statutory and fiduciary responsibilities for oversight of CSAC staff, EDFUND and the FFEL Program, as administered by EDFUND, and cannot delegate such responsibilities to other individuals or entities. While the Commission may prescribe through policies certain functions and responsibilities to CSAC staff, EDFUND staff, the EDFUND Board, and/or other individuals or entities to assist the Commission, all final decisions that involve the Commission's statutory and fiduciary responsibilities shall be made by the Commission. The Commission shall conduct its oversight responsibilities through Section 8.6 of this Agreement and through independent audits and reports from individuals and/or entities designated by the Commission. All audits required by Section 8.2 of this Agreement shall be reviewed by the Commission and EDFUND Audit Committees and be presented to the Commission and EDFUND Board. All reports required by Section 8.5 of this Agreement shall be provided to individuals and/or entities designated by the Commission.

8.2 Audits Supporting the Commission's Oversight Responsibilities. The following audits shall be performed in accordance with California Education Code Sections 69522(c)(2) and 69527(a); Title IV of the Higher Education Act of 1965, as amended; and/or any other applicable State or federal statutory provisions:

A. Annual Operating Fund and Federal Fund Financial Statement Audit – An independent certified public accountant shall provide to the Commission and the EDFUND Board the annual audited financial statements of the Operating Fund and Federal Fund.

B. Annual Audit of Internal Controls – An independent certified public accountant shall provide to the Commission and the EDFUND Board an annual audit of key system and non-system internal controls affecting the initiation, authorization, recording, processing and/or reporting of transactions including, but not limited to, the Operating Fund and Federal Fund. The Commission and EDFUND Audit

Committees will work with the independent certified public accountant to determine the specific control objectives that shall be tested.

C. Annual EDFUND Financial Statement Audit – An independent certified public accountant shall provide to the Commission and the EDFUND Board the annual audited financial statements of EDFUND.

D. Annual EDFUND 401(k) Plan Financial Statement Audit – An independent certified public accountant shall provide to the EDFUND Board the annual audited financial statements of the EDFUND 401(k) Plan.

E. Annual FFEL Program Compliance Audit – The Bureau of State Audits shall provide to the Commission the annual FFEL Program compliance audit findings issued by the Bureau of State Audits.

F. United States Department of Education Audits – The United States Department of Education shall provide to the Commission the audit findings issued by the United States Department of Education.

G. EDFUND Internal Audits – EDFUND shall provide to the Commission and the EDFUND Board the audit results of all internal audits conducted by EDFUND's Internal Audit Department as identified in the Annual Internal Audit Plan approved by the Commission and EDFUND Audit Committees.

H. Other Audits and Evaluations – This shall include any other review, audit or evaluation approved by the Commission's Audit Committee in consultation with the EDFUND Audit Committee and approved by the Commission in consultation with the EDFUND Board. This shall also include any other audits required by State or federal law, including the State auditor. Such reviews, audits or evaluations shall be conducted by an independent certified public accountant, independent consultant or such other independent individuals or entities designated by the Commission.

8.3 Availability and Access. EDFUND staff shall work with such individuals designated pursuant to this Article and be available for meetings within a reasonable period of time. CSAC and EDFUND shall provide full access to their facilities for any purpose associated with an audit upon forty-eight (48) hours notice or as otherwise agreed to by the parties.

8.4 Audit Issues or Findings. EDFUND agrees to respond to audit issues or findings in a timely manner.

8.5 <u>Reports Supporting the Commission's Oversight Responsibility.</u> EDFUND agrees to provide the following reports to the Commission or such individual(s) designated by the Commission, provided that the Commission may, in their discretion, discontinue any report due to obsolescence:

A. Annual Reports

(1) End of Federal Fiscal Year Loan Program Statistics which shall include:
(a) Guarantees
(b) Defaults
(c) Collections
(d) Claims
(e) Outstanding loans
Due no later than 75 days after federal fiscal year-end.

(2) Listing of all Participating Schools and Lenders, sorted by name. The listing will include the following:
(a) Name of the institution
(b) School/lender codes
(c) Location
(d) Number and dollar volume of loans sorted by loan program type
Due no later than 45 days after federal fiscal year-end.

(3) Annual Internal Audit Plan.
Due after the Commission and EDFUND Audit Committees review and approve the plan after their first meeting of the new federal fiscal year.

(4) Staffing analysis, as part of the budget process, to be provided with the preliminary annual budget proposal.
Due no later than July 15 of each year as part of the EDFUND annual budget process.

B. Quarterly Reports

(1) Updates to the Listing of Participating Schools and Lenders sorted by name. The listing will include the following:
a) Name of the institution
b) School/lender codes
c) Location
d) Number and dollar volume of loans sorted by loan program
Due no later than 30 days after quarter-end.

(2) Unaudited Financial Statements and Analysis. These include the following documents for the Operating Fund/EDFUND and Federal Fund:
a) Variance Report
b) Combined Statement of Assets
c) Statement of Activities
d) Statement of Cash Flows
e) Revenues and Expenses Variance Report
f) Notes to Financial Statements
Due no later than 45 days after quarter-end.

C. Monthly Reports

(1) Loan Program Statistics to include, but not limited to:
(a) Guarantees
(b) Defaults
(c) Collections
(d) Claims
(e) Outstanding loans
Due no later than 30 days after month-end.

(2) Updates to the Top 200 Schools and School Groups to include, but not limited to:
(a) Name of institution
(b) School/lender codes
(c) Location
(d) Number and dollar volume of loans sorted by loan program type
Due no later than 30 days after month-end.

(3) Unaudited Financial Statements. These include the following documents for the Operating Fund/EDFUND and Federal Fund:
a) Variance Report
b) Combined Statement of Assets
c) Statement of Activities
d) Revenues and Expense Variance Report
e) Notes to Financial Statements
Due no later than 45 days after month-end.

(4) Detailed Cash Flow Forecast for the Federal and Operating Funds.
Due no later than 30 days after month-end.

8.6 Annual Oversight Plan. The CSAC division/unit designated by the Commission and/or other entity designated by the Commission shall develop an Annual Oversight Plan, in consultation with EDFUND staff. The Annual Oversight Plan shall describe the oversight and any limitations associated therewith (including, but not limited to identification of EDFUND staff, systems and specific dates for such reviews that are needed to execute the Plan) and be approved by a Committee designated by the Commission in consultation with the EDFUND Audit Committee. The Annual Oversight Plan shall be designed to have the least intrusive impact on EDFUND operations and shall not be considered an audit. The Annual Oversight Plan shall be prepared in consultation with EDFUND staff no later than the fifteenth day of May of each year; adopted by a Committee designated by the Commission no later than the thirty-first day of August of each year; and adopted by the Commission in consultation with the EDFUND Board no later than the thirtieth day of September of each year.

ARTICLE IX
General Provisions

9.1 Corporate Obligation. This Agreement is a corporate obligation of EDFUND and an obligation of a public agency with respect to the Commission. Any liability arising hereunder shall be a corporate liability or, with respect to the Commission, governed by the California Education Code Section 69510 *et seq*. No commissioner, director, officer or employee of either party shall be subject to any liability to any other party for any action taken, or for refraining from taking action in good faith or for errors in judgment.

9.2 Waiver. No failure or delay on the part of either party in exercising any right, power or remedy hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy hereunder.

9.3 Amendments. No amendment or variation of the terms of this Agreement shall be valid unless made in writing, signed by the parties and approved as required. No oral understanding or Agreement not incorporated in the Agreement is binding on any of the parties.

9.4 Governing Law. This Agreement shall be construed in accordance with and be governed by the laws of the State of California.

9.5 Continuing Covenants. All covenants, agreements, representations and warranties contained herein shall extend to, inure to the benefit of and bind all assignees and successors of the respective parties hereto, and the representations, warranties and covenants herein contained shall survive the termination of this Agreement, but shall not be deemed to have been made with respect to any period of time subsequent to the termination of this Agreement.

9.6 Notice. No written notice required to be given hereunder shall be effective until received by the party, with proof of delivery, to whom addressed, or until five (5) calendar days after mailing to the addressee, whichever is earlier.

9.7 Force Majeure. If either party is rendered unable, wholly or in part, by a force outside the control of the parties (including, but not limited to, acts of God or the public enemy, acts of government in either its sovereign or contractual capacity, strikes, lockouts, riots, acts of war, terrorism, epidemics, fire, communication line or power failure, changes in applicable law, embargoes, weather, quarantine, earthquakes, or other disasters) to carry out its obligations under this Agreement, that party shall give to the other party prompt written notice to that effect; thereupon, the affected obligations of the party giving the notice, shall be suspended so long as such party is unable to so perform and such party shall have no liability to the other for the failure to perform any suspended obligation during the period of suspension; however, this provision is not intended to modify or abrogate in any way the right of a party to terminate this Agreement if a condition for termination specified elsewhere herein exists.

9.8 Cooperation between Parties. The Commission and EDFUND agree that they will cooperate promptly and fully with one another in order to carry out the terms and provisions of this Agreement and SLA. The Commission and EDFUND also agree to mutually promote and support each other in the market place.

9.9 Guarantee Services Outside of California. Guarantee services conducted outside of California may be marketed under the EDFUND name.

9.10 Duly Authorized. Each party with respect to itself represents and warrants that the making and performance of this Agreement and the activities contemplated hereby (i) have been duly authorized by all necessary corporate, statutory, regulatory or Commission action, and (ii) do not and will not violate any provision of law, or any regulation, order, decree, writ or injunction, or any provision of its governing statute or instrument.

This Agreement is the legal, valid and binding obligation of such party, enforceable in accordance with the terms hereof subject to the exercise of judicial discretion in accordance with general principles of equity, to the valid exercise of the police powers of the several states of the United States of America, and of the constitutional powers of the United States of America and to bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally.

9.11 Safeguards and Information Security. Throughout this Agreement, CSAC and EDFUND shall implement and maintain appropriate safeguards, as that term is used in the Federal Trade Commission's Safeguards Rule ("Safeguards Rule") at 16 C.F.R. §314 *et. seq*., for all Customer Information as defined at §314.2 *et. seq*. of the Safeguards Rule, as well as all Confidential Information provided to CSAC and/or EDFUND by any borrower, only as necessary to perform the services as set forth in this Agreement. CSAC and/or EDFUND agrees to not disclose such information provided to them with any third party other than as permitted in this Agreement and SLA, or as permitted by Title IV of the Higher Education Act of 1965, as amended. In addition, the parties agree to comply with any other state and federal laws.

9.12 Custodian of Records, Examination. EDFUND shall serve as the custodian of all CSAC records and systems pertaining to the FFEL Program under possession and control as defined by Federal Trade Commission's Safeguards Rule, at 16 C.F.R. §314.1(b). The Commission shall be granted complete right and access to such records and systems upon request.

9.13 Confidentiality. Subject to the requirements of applicable law, including the Bagley-Keene Open Meeting Act, California Government Code Section 11120 *et seq.,* the Public Records Act, California Government Code Section 6250 *et seq*., and California Education Code Section 69525(g), both parties agree to maintain the confidentiality of documents and other information provided under this Agreement to the fullest extent possible, including all those marked "Proprietary and Confidential."

9.14 Contract Manager. The Commission and EDFUND shall each designate in writing a Contract Manager within ten (10) days of signing this Agreement.

All notices to be provided under this Agreement shall be directed to the Contract Manager. In addition, each party agrees to communicate any material issues or disputes arising out of this Agreement to the other party's Contract Manager. Both Contract Managers are to use their best efforts to resolve any such issues or disputes in an informal manner. Either party may change the designation of its Contract Manager at any time upon written notice to the other party. In addition to the Contract Managers designated, copies of all notices and communications as described in this paragraph shall be provided to the legal counsel for both parties.

9.15 Dispute Resolution. The parties will attempt in good faith to resolve through informal negotiation any issue, dispute, claim, controversy and/or breach (hereinafter referred to as breach) arising out of or relating to this Agreement. Any breach that cannot be so resolved, shall first be presented to the respective Contract Managers for the Commission and EDFUND. If the respective Contract Managers cannot resolve the issue within five (5) business days, the issue shall be presented to the Executive Director of CSAC or a designee of the Commission and the President of EDFUND or designee of EDFUND. The Executive Director or designee and the President or designee shall make every good faith effort to resolve the issue. In the event the breach cannot be resolved by the Executive Director or designee and the President or designee within five (5) business days of receipt, the Chairs of the Commission and the EDFUND Board shall be notified and a joint meeting of the Commission and the EDFUND Board shall be noticed and shall take place within twenty (20) business days of reporting the issue to the Chairs to attempt to resolve the breach. In the event the breach cannot be resolved by the Commission and EDFUND Board, the Commission's decision shall be final. In the event EDFUND disagrees with the Commission's final decision, EDFUND may move forward with mediation.

In the event of a breach to this Agreement, nothing herein shall prevent the Commission or the EDFUND Board from pursuing all other legal avenues available to the parties, including but not limited to legal action. However, both parties agree that prior to any legal action they will attempt to resolve their issues in an amicable manner through mediation administered by the American Arbitration Association under its Commercial Mediation Rules. Nothing herein shall prevent the parties from mutually agreeing to settle an issue through arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules.

The parties agree that the venue for any action pursuant to this Section shall be Sacramento County, California. EDFUND's costs for mediation, arbitration or legal action shall be reimbursed by CSAC, except in the event of a finding of bad faith on the part of EDFUND in the subject action.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered as of the day and year first above written.

California Student Aid Commission

By: ____________________________
Louise McClain
Commission Chair
California Student Aid Commission
Date: ____________________________

By: ____________________________
Diana Fuentes-Michel
Executive Director
California Student Aid Commission
Date: __________________________

EDFUND

By: __________________________
Sally M. Furay
Board of Directors, Chair
EDFUND
Date: __________________________

By: __________________________
Samuel M. Kipp, III
President
EDFUND
Date: ________________________

SERVICE LEVEL AGREEMENT

This Service Level Agreement (SLA) is effective the first day of July 2007, between the California Student Aid Commission (CSAC), a public agency of the State of California and EDFUND, a nonprofit public benefit corporation organized under the laws of the State of California. This SLA is a separate document from the Operating Agreement (Agreement) between CSAC and EDFUND and shall enumerate specific services to be performed by CSAC and/or EDFUND in connection with the Operating Agreement, entered into by the parties on the first day of July 2007. This SLA shall continue until terminated or amended.

SECTION I
FFEL PROGRAM SERVICES

Unless otherwise specified, EDFUND agrees to provide the following FFEL Program operational, support and administrative services:

1) **GUARANTY** – includes, but is not limited to: (a) application processing and printing, and approving the loan for guarantee, including Lender of Last Resort; (b) general loan maintenance and reporting; (c) borrower, lender and school inquiry services; (d) fee remittance and collection; and (e) customer-facing product development and administration.

2) **DEFAULT AVERSION AND PREVENTION** – includes, but is not limited to: (a) processing of default aversion assistance requests; (b) borrower counseling for a successful repayment experience; (c) skip tracing; and (d) school-based default aversion services.

3) **LENDER CLAIM ADJUDICATION AND PAYMENT SERVICES** – includes, but is not limited to: (a) claim review, processing, certification, reject control and claim payment disbursement; (b) claim repurchases and adjustments; and (c) processing bankruptcy documents.

4) **POST DEFAULT SERVICES** – includes, but is not limited to: (a) borrower disputes and appeals prior to the Ombudsman level; (b) administrative review; (c) processing Treasury and State offsets; (d) review of loan discharges for reason of false certification, closed school, permanent and total disability and death; and (e) research and referral to the Ombudsman of suspected fraud and for handling with the Office of the Inspector General – U.S. Department of Education (OIG-USED) and other law enforcement agencies as appropriate.

5) **DEFAULTED LOAN COLLECTION SERVICES** – includes internal and external collections.

6) **PROGRAM OVERSIGHT AND COMPLIANCE SERVICES** – includes school and lender reviews and related activities.

7) **FINANCIAL AND PROGRAM REPORTING** – includes, but is not limited to: borrower, school or lender payment processing, disbursing and reporting; subrogation; loan consolidation processing, such as: (a) Federal reporting – preparation and submission of

required FFEL Program financial and accounting reports that includes the U.S. Department of Education Form 2000; (b) CSAC reporting – preparation and submission of financial forecasts and analysis on the Federal and Operating Funds; (c) Program Invoicing and Disbursements – preparation and submission of EDFUND operating expenses, fixed assets, CSAC support activities expenses, federal default fee disbursements, and claim payment processing.

8) **COMMUNICATIONS, TRAINING AND SUPPORT** – includes, but is not limited to: (a) producing, maintaining and distributing financial aid brochures, booklets and other public information; (b) conducting loan-related training for postsecondary schools and lenders; (c) establishing and maintaining liaison activities with the financial aid community; (d) maintaining a list of all FFEL Program memberships and associations; and (e) coordinating as appropriate, with CSAC staff and EDFUND staff, and listing all parties involved in shared partnership projects.

9) **BUSINESS DEVELOPMENT AND MARKETING** – includes, but is not limited to: (a) developing and enhancing loan-related products and services; (b) marketing of services and products; (c) establishing and maintaining relationships with schools and lenders; and (d) any activities supporting these functions.

10) **POLICY, RESEARCH AND LEGISLATIVE ASSISTANCE** – includes, but is not limited to: (a) collecting guarantor policy and management data; (b) providing regulatory guidance, analysis and interpretation to ensure compliance with FFEL Program requirements; (c) identifying and proposing policy for the Commission's consideration and approval; (d) conducting and producing loan research and reports; and (e) performing data modeling, analyzing and tracking legislation as it relates to the loan program, and advocating legislative and regulatory positions as directed by the Commission.

11) **TECHNOLOGY SERVICES** – includes, but is not limited to: (a) ensuring quality, delivery, maintenance and support of hardware and software systems used to provide loan services to customers including managing and providing oversight for the systems and processes that are outsourced; (b) providing technical support to customers; (c) designing, developing and implementing new technology to support FFEL Program regulatory requirements or enhance current services; and (d) providing technology infrastructure support.

12) **LEGAL SERVICES** – includes, but is not limited to: providing representation and/or management of outside counsel for EDFUND and/or CSAC in matters relating to any federal, state or local law or regulation in any business, government, or dispute resolution forum related to the implementation and/or provision of this Agreement, SLA or any CSAC responsibility under the FFEL Program. EDFUND on behalf of the Commission will provide any other services requested of EDFUND by the Commission and agreed upon by the parties.

13) **OMBUDSMAN SERVICES** – includes, but is not limited to: (a) providing an Ombudsman Office to handle and resolve borrower complaints regarding CSAC and/or EDFUND, which are referred internally, by CSAC or by customers and partners, including but not limited to, student loan borrowers, schools, lenders, other governmental and legislative offices (federal and state) and the U.S. Department of Education; (b) administering the compromise, settlement or write-off of loans based on Commission-approved policies;

and (c) research of and referral to the Ombudsman of suspected fraud and for handling with OIG-USED and other law enforcement agencies.

14) **OTHER LOAN SERVICES** – includes, but is not limited to: (a) submitting and maintaining loan data on the National Student Loan Data Systems (NSLDS); (b) completing cohort default appeals which includes production of any necessary reports; (c) processing school and lender requests for participation in the Commission's FFEL Program; (d) providing support to the Commission's Loan Advisory Council which includes making presentations and on occasion providing other services as needed or requested, and (e) any other loan services that may on occasion, be assigned by the Commission and agreed upon in writing by both parties.

SECTION II
OTHER SUPPORT SERVICES

EDFUND agrees to provide additional support services as specified in the Charge Back Agreement between EDFUND and CSAC, and bill CSAC for the charges within five (5) business days of EDFUND'S monthly close. Estimated costs for services will be established and agreed upon, prior to the first day of October of each year by CSAC and EDFUND, and will be documented in the Charge Back Agreement. Supporting documentation for costs will be provided including a schedule of rates. Other services not listed below will be agreed to in writing and will become part of this SLA as an amendment. The written agreement will outline the services to be provided with estimated costs and performance expectations. The additional support services to be provided are:

1) **SUPPLY SERVICES** – office supply orders

2) **REPORT DISTRIBUTION** – system generated internal and external reports

3) **MAIL PROCESSING SERVICES** – process incoming and outgoing mail and delivery, messenger and express mail services

4) **PRINTING SERVICES** – printing, copying, assembling and distribution

5) **SECURITY SERVICES** – security guard services, coordinate physical security of facilities and staff, facility access

6) **WAREHOUSE SERVICES** – storage of CSAC materials, assembling and shipping, processing publication orders

7) **TRANSPORTATION SERVICES** – vehicle maintenance and tracking

8) **RECORDS MANAGEMENT** – establish and maintain records retention schedules including retrieval of records

9) **COMMON AREA USAGE** – use of Board Room, conference rooms, cafeteria and storage rooms

10) **TECHNOLOGY SERVICES** – voice, video and data center support

11) **CLIENT RELATIONS SERVICES** – grant training, information dissemination and customer service support

12) **STAFF TRAINING AND DEVELOPMENT SERVICES** – access to EDFUND's training and development classes/sessions

13) **INVENTORY SERVICES** – maintain records for the acquisition and disposition of property

14) **OTHER SERVICES** – as requested by CSAC, provide other services including, but not limited to, publication and video production; Compact Disk read-only memory (CD-ROM) software product development or other technology consulting services or research.

SECTION III
EDFUND REPORTS / INVOICES / PUBLICATIONS

Reports necessary for day-to-day operations are to be provided to CSAC in a timely manner and in the following frequency indicated with format and media requested or agreed upon by both parties.

Reports / Invoices / Publications – Annual

RA-1 EDFUND will assist CSAC staff in the preparation of the first draft of the California Student Aid Commission's Annual Report to the California State Legislature on EDFUND and agrees to assist CSAC staff in any edits and updates.

RA-2 One major research project on a topic designated by CSAC, and based upon availability of funding and quality of data.

RA-3 Major and Minor Property Inventory Reports and Construction in Progress (CIP) Report as of June 30 for property purchased for use in the General Fund, Operating Fund and Grant Fund. The reports will include the following reporting categories:

- Property item
- Description
- Cost
- Date of acquisition
- Cost center
- Asset category
- Tag number
- Asset number (Oracle number)
- Net book value (at period end for Major only)
- Year-to-date depreciation (Major only)

Due no later than July 31 each year.

RA-4 EDFUND shall provide a report of its market share of California, Western Region and Nationwide when the actual Federal Student Loan data is available, typically in March of the following year.

<u>Reports / Invoices / Publications – Quarterly</u>

RQ-1 Technology Major Projects Status Report (confidential and proprietary). Mission critical projects generally will be identified in the annual TSS Strategic Report. The status report, at a minimum should include the following reporting categories:

- Project name and description
- Project start date
- Estimated completion date
- Milestone and budget status
- Issues/concerns.

Due no later than the 10th of the month following quarter-end.

RQ-2 Telecommunication usage summary report for CSAC staff that includes detailed phone usage for only the last month of each quarter. The report shall be sorted by unit, name and phone number.
Due no later than ten (10) business days after quarter-end.

<u>Reports / Invoices / Publications – Monthly</u>

RM-1 Accruals for the Federal and Operating Funds including but not limited to:

- Fund type
- GL#
- Description
- Source
- Amount

Due no later than the 13th of the month following the reporting period, except for June accruals, which will be due no later than July 12.

RM-2 CSAC Major Equipment Reconciliation – from Oracle (for assets purchased prior to February 1, 2001 – CSAC's assets)
Due no later than five (5) business days after EDFUND's month-end close.

RM-3 Loan Program Assets Purchased on or after February 1, 2001 – Depreciation Schedule.
Due no later than five (5) business days after EDFUND's month-end close.

RM-4 Invoices for services to CSAC for support activities will include supporting documentation such as purchase orders and journal entries. Supporting documentation for telecommunication will include vendor billings and divisional charges. Due no later than five (5) business days after EDFUND's month-end close. Additional supporting documentation for invoices as requested by CSAC staff will be provided no later than seven (7) business days of request.

RM-5 Supporting documentation for telecommunication invoices will include a usage report summarized by unit and sorted by phone and name.
Due no later than five (5) business days after EDFUND's month-end close.

RM-6 Monthly inventory reports of all publications and forms that reflect:

- Current stock on hand
- What institutions have ordered and what has been mailed
- What institutions have ordered but have not been mailed (back orders)

Due the 1st week of each month.

RM-7 Personnel Staffing Report (2-Page FLASH Report), excluding non-personal information, that includes:

- Staffing
- Vacancies/EEO recruitment
- Training
- Labor relations
- Leaves of absence
- Separations
- Performance reviews

Due no later than the 10th of each month.

<u>Reports / Invoices / Publications – Special</u>

RS-1 Reports for Commission and Loan Advisory Council Meetings – oral and written reports on requested topics including completed agenda tabs and supporting documentation.

RS-2 Within ten (10) business days of request, provide a detailed summary of phone usage for a specific timeframe upon request by the Management Services Division of CSAC.

RS-3 Other special reports as may be requested and agreed upon by both parties.

<u>Reports / Invoices / Publications – Other Reports</u>

RO-1 EDFUND will develop the loan program strategic plan and an annual plan delineating specific action steps to implement the strategic plan. EDFUND will provide quarterly updates on the progress of implementing the strategic plan.
Due date to be mutually agreed upon.

SECTION IV
CSAC REPORTS / INVOICES / PUBLICATIONS

Reports necessary for day-to-day operations are to be provided to EDFUND in a timely manner and in the following frequency indicated with format and media requested or agreed upon by both parties.

CSAC Services – Annual

CA-1 Detailed information necessary for annual budget development.
a) Personnel benefit percentages
b) Prorata
c) Grant Administration Budget
d) Capital Assets included in the Grant Administration Budget (including: description, useful life, estimated purchase date, estimated in service date, and contact person).

Due each year, ongoing, from February through June.

CA-2 Information necessary for notes to the financial statements for the annual audits.
a) Cash and Cash Equivalents (Surplus Money Investment Fund (SMIF)/Pooled Money Investment Account (PMIA)) as of June 30
b) Pension Benefits as of June 30 and September 30
c) Post-Employment Benefits Other Than Pensions as of June 30 and September 30
d) Commission Minutes for the twelve (12) months under audit as of June 30 and September 30.

Due each year, no later than, seven weeks after State and federal fiscal year-end.

CSAC Services – Monthly

CM-1 Monthly and Period Fiscal Month-13 California State Accounting and Reporting System (CALSTARS) Accounting Reports (G01, Q12, Q24, D09 and Q16) in both hard and soft/Monarch copy (used to prepare Fund Financial statements).
Due no later than the 5th business day after CSAC receives the Operating and Federal Fund accruals from EDFUND.

CM-2 CSAC feedback of their specific budgeted line items on update Annual Forecast (i.e. reprojections) column in the monthly financial reports.
Due no later than the 11th business day of the following month.

CM-3 State Controller's Office (SCO) Fund Reconciliation Report and Agency Reconciliation Report used to prepare SMIF interest accruals.
Due no later than the 3rd business day of the following month.

CM-4 Civil Service Payroll and Vacation accrual entries.
Due no later than the 6th business day of the following month.

CM-5 Monthly Accounting Schedules

a) Claim Schedules (Claim Purchased/Adjusted Report (CPA) – Lender Payments) and all other reimbursements for EDFUND activities)
b) Invoices paid
c) Reimbursement and Minimum Reserve Subsidy
d) Revenue-Type Account
e) Collection Activity (in/out Due From/To accounts)
f) Sweep Interest

Due no later than the 5th business day after CSAC receives the Operating and Federal Fund accruals from EDFUND.

CM-6 Federal Fund Cash Flow Detailed Schedule and Operating Fund Cash Flow Detailed Schedule

Due no later than the 5th business day after month-end.

<u>CSAC Services – On an Ongoing Basis as CSAC Receives</u>

CO-1 CSAC staff agrees to provide EDFUND with the Free Application for Federal Student Aid (FAFSA) data with copies of all the Institutional Student Information Reports (ISIRS) as received by CSAC. ISIRS records will be transmitted electronically on an ongoing basis to EDFUND as they are received by CSAC. In addition, CSAC will provide EDFUND with the associated documentation, i.e., the record position of each data element, by the number of the element, and a copy of the FAFSA with the data element numbers on it. Data will be delivered in the format that CSAC receives from the U.S. Department of Education's Central Processing System (CPS).

If any expenses are incurred, EDFUND agrees to pay for half.

CO-2 CSAC will acknowledge and recognize EDFUND in all shared partnership projects.

SECTION V
PERFORMANCE EXPECTATIONS

CSAC and EDFUND agree to perform all services required pursuant to this Agreement according to best practices, and according to performance expectations mutually agreed upon in an amendment to this SLA, adopted no later than the thirty-first day of July 2007.

Until such performance expectations are adopted, EDFUND agrees to continue with the performance expectations outlined in Exhibit D of the Operating Agreement in effect on June 30, 2007. Such performance expectations may include, but shall not be limited to:

- Guaranty
- Default Aversion
- Claims
- Collections
- Program Oversight
- Technology
- Financial
- Information Security
- Other Support Services

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered as of the day and year first above written.

California Student Aid Commission	EDFUND
By:______________________________	**By: _____________________________**
Louise McClain	**Sally M. Furay**
Commission Chair	**Board of Directors, Chair**
California Student Aid Commission	**EDFUND**
Date:_____________________________	**Date: ___________________________**
By: ______________________________	**By: _____________________________**
Diana Fuentes-Michel	**Samuel M. Kipp, III**
Executive Director	**President**
California Student Aid Commission	**EDFUND**
Date: _____________________________	**Date: ___________________________**