

Action/Information Item

California Student Aid Commission

Consideration of a Commission Resolution on Fulfilling the Commission's Responsibilities as the Single State Agency Designated by the Federal Government Under the Federal Family Education Loan Program to be the Student Loan Guarantee Agency in California, Consistent with Article III of the Articles of Incorporation of EDFUND, and Chapter 182 of the Statutes of 2007 (SB 89)

Recommendation

Adopt the attached resolution stating that the Commission has, and will exercise, full authority under both federal and state law to administer the Federal Family Education Loan Program (FFEL Program) as the student loan guarantee agency designated by the United States Department of Education. To the extent that the Commission concludes that a decision by the Department of Finance under Chapter 182, Statutes of 2007 (SB 89) results in a conflict that causes the administration of the FFEL Program to be inconsistent with federal law, the Commission will consult with the United States Department of Education.

Summary

California law authorizes California to participate in the Federal Family Education Loan Program (FFEL Program), which provides federally guaranteed student loans to facilitate access to postsecondary education. The United States Department of Education has designated the California Student Aid Commission to be the state student loan guarantee agency for California.

Senate Bill 89 (Chapter 182, Statutes of 2007) ("SB 89"), enacted after the Governor proposed to sell the State's student loan guarantee program assets, granted the Department of Finance authority to approve Commission actions and to take necessary action to preserve the value of state student loan guarantee assets until the consummation of their sale or any other transaction, to maximize the value of the FFEL Program to the State.

The Department of Finance originally directed the Commission to follow a process by which the Commission should act as it deemed appropriate, then send a request to the Department of Finance for approval of the Commission's action. The request was to include a statement of the Commission action, an analysis of the issues, and the views of EDFUND, the Commission's auxiliary organization through which the Commission conducts its FFEL Program operations.

However, the Department of Finance has not uniformly conformed to its process. It has attempted to preempt the formal process for approval by directing the Commission, both formally and informally, to act or not act, in the way the Department of Finance desires. The Department of Finance has not consulted with the Commission before attempting to direct the Commission to act, thus, the source of information to the Department of Finance is unclear.

Further, the Department of Finance has taken a very broad view of the concept of preserving the value of state student loan guarantee assets for sale, to the point at which official and unofficial actions by the Department of Finance have interfered with services to students that the Commission, in its role as the designated state student loan guarantee agency, believes necessary to provide.

The purpose of the attached resolution is to state the Commission's official position on its responsibilities under SB 89, and the process it will follow to conform to SB 89.

Discussion

A summary of the relevant policy and legal considerations may be helpful.

The Fundamental State Student Loan Guarantee Program Asset is the Federal Government's Designation of the Commission as the State Student Loan Guarantee Agency for California.

Federal law establishes the Federal Family Education Loan Program, under which the federal government guarantees loans issued by private lenders to students and their parents, to finance the costs of higher education. The Secretary of the United States Department of Education (USDE) is authorized to contract with a state or a nonprofit institution or organization to act as a student loan guarantee agency to administer the FFEL Program in a state. (See 20 USC §1078.)

Federal law, however, requires that a state program must be administered by a single state agency. (See 20 USC §1078(b)(K); 34 CFR §682.401(b)(16).) In other words, USDE will contract with a state to act as a student loan guarantee agency only if a single state agency will be responsible to administer the FFEL Program in that state.

California law authorizes California's participation in the FFEL Program and authorizes the Commission to serve as a state student loan guarantee agency. (Education Code, §§ 69760, 69761.5.)¹ Among other things, California law designates the Commission as the California state agency to receive any federal funds for administrative costs and payment of guarantee obligations. (§69761.5(a).)

The Commission and USDE entered into a continuing agreement in 1978 authorizing the Commission to operate under the FFEL Program, making the Commission the designated state student loan guarantee agency for California.

Thus, all the responsibilities of the Commission with respect to the FFEL Program, and all the benefits, including revenue in the form of fees earned for activities required by the FFEL Program, derive from USDE's designation of the Commission as the state student loan guarantee agency for California.

¹ All citations are to the Education Code unless otherwise indicated.

This point cannot be overemphasized. Within SB 89 is the definition of “state student loan guarantee program assets”, it provides:

“State student loan guarantee program assets” means all of the assets of the state student loan guarantee program held by the Student Aid Commission and all assets of the auxiliary organization, tangible and intangible, including, without limitation, the state’s interest in all loan guarantee contracts and agreements, the funds deposited in the Student Loan Operating Fund other than federal funds, all funds held by the auxiliary organization other than federal funds, and the state’s interest in any leases of real property or equipment entered into by the auxiliary organization. These assets shall not include any property of the United States held by the Student Aid Commission or the auxiliary organization, as determined pursuant to Public Law 94-482, or subsequent federal regulations.

(Education Code section 69521(h).)

Without the federal government’s designation, the State would not have accumulated any of the items included in the section 69521(h), because the Commission would have had no authority to guarantee student loans or to receive revenue from the federal government for undertaking the FFEL Program activities.

The fundamental state student loan guarantee program asset, from which all other assets are derived, is, therefore, the federal government’s designation of the Commission as the state student loan guarantee agency for California.

Any Diminishing of the Commission’s Authority and Responsibility as the State Student Loan Guarantee Agency Potentially Devalues the State Student Loan Guarantee Program Assets.

Federal law authorizes a single state agency to administer the FFEL Program, and requires that single state agency to be accountable for, and to exercise full authority over, the nonprofit private institutions it uses to administer the FFEL Program.

In 1996, the Legislature enacted legislation authorizing the Commission to create a nonprofit auxiliary organization to provide operational and administrative services to the Commission for the Commission’s participation in the FFEL Program. (Chapter 961, Statutes of 1996 (AB 3133).)

Federal law authorizes a state student loan guarantee agency to administer the FFEL Program through a nonprofit organization, but is explicit in requiring the guarantee agency to have and to exercise full authority over, and have accountability for, the nonprofit organization:

In the case of a State loan guarantee program administered by a State government, the program must be administered by a single State agency, or by one or more private nonprofit institutions or organizations under the supervision of a single State agency. For this purpose, “supervision” includes, but is not limited to, setting policies and procedures, and having full responsibility for the operation of the program.

(34 CFR §682.401(b)(16); emphasis added.)

To this end, California law requires the Commission to maintain its responsibility for financial aid program administration, policy leadership, program evaluation, and information development and coordination, if it administers the FFEL Program through an auxiliary organization. (§ 69522(c)(1).) California law also specifies that the Commission must use the auxiliary organization to enhance the administration and delivery of Commission programs and services. (See §69522(c)(3).) Further, it prohibits the auxiliary organization from providing operational and support services that are not determined by the Commission to be consistent with the overall mission of the Commission. (§69522(c)(1).)

Thus, federal and state laws require the Commission to have and to exercise full authority over, and have accountability for, any auxiliary organization it creates.

The Commission created an auxiliary organization that has no authority to act independently of the Commission's mission, policies and direction.

The Commission used the legislation enacted in 1996 to create an auxiliary organization in 1997. As required by California law, the Commission created the auxiliary organization, EDFUND, as a nonprofit public benefit corporation. (§69522(b).)

The Commission defined the full extent of the auxiliary organization's authority in its statement of the auxiliary organization's charitable purpose as follows:

The charitable purposes for which this corporation is organized are to promote and assist the programs of the California Student Aid Commission. This corporation is organized, and at all times hereafter, will be operated exclusively for the benefit of, to perform the functions of, and to carry out the purposes of said Commission.

(Article III, Articles of Incorporation of EDFUND.)

The charitable purposes thus prescribe EDFUND to be operated exclusively for the benefit of the Commission, to perform the functions of the Commission, and to carry out the purposes of the Commission. Since California law also mandates that the Commission maintain its responsibility for financial aid program administration, policy leadership, program evaluation, and information development and coordination, it is for the Commission to define for EDFUND, the auxiliary organization, how EDFUND is to operate exclusively for the benefit of the Commission. (See §69522(c)(1).)

Despite the fact that California law and the Articles of Incorporation establish the Commission's authority and responsibility over its auxiliary organization, the exercise of the Commission's authority over, and governance of, the auxiliary organization has been problematic.

In 2005, the California State Auditor audited a past-Commission's oversight of the auxiliary organization at the request of the Joint Legislative Audit Committee, and faulted that Commission for maintaining poor oversight of its auxiliary organization. That poor oversight was demonstrated by the past-Commission's approving EDFUND's business plan without addressing concerns raised by Commission oversight staff, approving sizable bonuses for the EDFUND's executive staff despite the fact that the FFEL Program had an operating deficit, and by its not ensuring that EDFUND's travel and business

expense policies are fiscally conservative, resulting in less funding available for the Commission to fulfill its mission. (Report No. 2005-120, California State Auditor, pp. 62-63; April 20, 2006, transmittal letter from Elaine M. Howle, State Auditor.) Further, the California State Auditor concluded that on-going tensions between the Commission and its auxiliary organization delayed completion of critical tasks.

Among other things, the California State Auditor recommended that the Commission “[e]nsure that the roles and responsibilities it delineates for itself and EDFUND do not inappropriately cede its statutory responsibilities to EDFUND.” (Report No. 2005-120, California State Auditor, p. 34.)

That past-Commission took steps to attempt to resolve the issues addressed by the California State Auditor report. A months-long effort, in public sessions, resulted in a version of Commission policies for self-governance and governance of its auxiliary organization. However, as a result of the enactment of SB 89, the basic question of the Commission’s ability to exercise authority over its auxiliary organization has been called into question.

The attached resolution is presented to the current Commission as an effort to establish a policy statement on the responsibility of the Commission, with respect to the oversight of its auxiliary organization, during the pendency of SB 89.

In an Effort to Attempt to Prevent the Devaluation of the State Student Loan Guarantee Program Assets, The Department of Finance Should Exercise Its Authority Under SB 89 Restrictively; A Broad Interpretation of the Authority Granted by SB 89 Could Conflict with Federal Law

SB 89 not only authorized the Department of Finance, in consultation with the State Treasurer, to sell state student loan guarantee program assets, or to enter into an alternative arrangement, but also granted additional authority to the Department. Specifically, SB 89 provided:

The Director of Finance is authorized to take all actions that he or she deems to be necessary or convenient to accomplish any of the following:

- (1) To preserve the state student loan guarantee program assets, pending consummation of their sale or the consummation of any other transaction, to maximize the value of the state student loan guarantee program to the state....

(§69521.5(a)(1).)

Further:

Until the consummation of the sale or other transaction to maximize the value of the state student loan guarantee program to the state, all actions, approvals, and directions of the State Aid Commission affecting the state student loan guarantee program shall be effective only upon the approval of the Director of Finance.

(§69521.5(c)(3).)

In addition, California law provides:

The Student Aid Commission shall cooperate fully with the Director of Finance and, in particular, take all steps to preserve the state student loan guarantee program assets deemed necessary or convenient by the Director of Finance....

(§69521.5(c)(1).)

SB 89 raises serious issues that potentially devalue the state student loan guarantee program assets.

Specifically, the validity of the State's administration of the FFEL Program is threatened when the single state agency responsible under federal law is overruled in its exercise of supervision or oversight responsibility for its nonprofit auxiliary organization. Federal law requires the Commission to have and to exercise full and sole responsibility over the nonprofit organization it uses to administer the FFEL Program. SB 89, however, has given two state agencies authority to make decisions over the nonprofit by authorizing the Department of Finance to act to preserve the value of the state student loan guarantee program assets. The state student loan guarantee program assets, therefore, could be devalued by that inconsistency with federal law.

Further, under federal law, full accountability for the nonprofit organization is required to accompany authority of the federally-recognized single state agency over the nonprofit. While SB 89, however, gives the Department of Finance authority over the Commission's nonprofit, federal law does not recognize any accountability on the part of the Department of Finance because the federal government recognizes only the Commission as the state student loan guarantee agency. Essentially, the Commission is solely accountable to the federal government for the Department of Finance's decisions, but the Department of Finance, contrary to federal law, does not have accountability to the federal government for its decisions.

This inconsistency with federal law also potentially devalues the state student loan guarantee program assets, unless, as a practical matter, the Department of Finance's decision-making is extremely limited and related solely to matters related to a pending sale, and defers to the Commission's independent exercise of its discretion and authority over FFEL Program administration and its nonprofit auxiliary organization..

In addition, the Department of Finance's implementation of SB 89 has raised procedural and substantive issues.

The Department of Finance seems to have preempted its own process for making decisions under SB 89 by acting on information without consultation with the Commission.

As indicated above, after SB 89 became effective, the Department of Finance directed the Commission to follow a process by which the Commission should act as it deemed appropriate, then send a request to the Department of Finance for approval of the Commission's action. The request was to include a statement of the Commission action, an analysis of the issues, and the views of EDFUND, the Commission's auxiliary organization through which the Commission conducts its FFEL Program operations.

Despite establishing this process, it is Commission staff's observation that the Department of Finance has preempted it as it sees convenient. Before Commission

action on an issue, the Department of Finance has attempted to direct the Commission formally and informally, to act in certain ways without consulting with, or receiving information from, the Commission.

For example, as the Commission is aware, the Commission has sought to promote access to postsecondary education by providing information to students and parents on paying for college. This effort was accomplished in previous years through the Commission's public awareness campaign, and, in partnership with the Los Angeles Chamber of Commerce, College Access Foundation, Cal-SOAP projects, and segmental partners, the Cash for College campaign. The Commission authorized and financed these information efforts from FFEL Program revenues to serve its responsibilities as a designated student loan guarantee agency under the FFEL Program, and additionally, as part of its Cal Grant responsibilities.

At a July 14, 2008 Commission meeting, the Commission voted to support using FFEL Program funds for the public awareness campaign, and authorized the Chair to send a letter to the Chair of the EDFUND Board of Directors and the EDFUND President indicating that the proposed EDFUND budget for 2008-09 should include \$1.719 million in funding for the public awareness campaign.

The Commission action did not approve the EDFUND budget for 2008-09, nor did it authorize the expenditure for the public awareness campaign. That action would not be taken until September 2008, at the earliest.

However, by letter dated July 17, 2008, the Director of Finance indicated that he felt it appropriate to express his concerns, and stated that he felt that the proposed expenditure would have the effect of "devaluing the asset prior to sale or other transaction, which is of great concern to me."

The Director did not provide an explanation for how the expenditure would devalue "the asset." He asserted that the Commission's action was inconsistent with the Legislature's failure to appropriate funding in the proposed 2008-09 State budget, but this argument focuses on purported legislative intent rather than the way in which the asset is devalued. The Director did not suggest alternatives that would not, in his perception, devalue the asset.

It is possible, however, that the Department of Finance could be characterized as devaluing the asset if it carries through with the intent to disapprove a future Commission authorization to fund the public awareness campaign as required by federal law. Federal law provides:

Each guaranty agency shall undertake such activities as are necessary to promote access to postsecondary education for students through providing information on college planning, career preparation, and paying for college. The guaranty agency shall publicize such information and coordinate such activities with other entities that either provide or distribute such information in the States for which such guaranty agency serves as the designated guarantor.

(20 USC §1092e(b)(2).)

The Department of Finance could be viewed as rendering California's administration of the FFEL Program out of compliance with federal law by refusing the Commission the

means by which to comply to the extent the Commission deems necessary with the obligation imposed by federal law on all student loan guarantee agencies.

Not all efforts at preemption by the Department of Finance have been formal. Several former Commissioners and Commission staff members have been in meetings with senior Department of Finance representatives at which the Department of Finance representatives have attempted to direct the Commission to act, or refrain from acting, in certain ways.

For example, in response to adverse publicity about the EDFUND Board's considering severance agreements for some EDFUND executives and violating the Open Meeting Act to discuss the severance agreements in closed session, the Department of Finance told Commission representatives at a meeting in June 2008 that while the severance agreements similar to those discussed were not acceptable, retention agreements or bonuses for a more limited number of EDFUND executives could be acceptable. The Commission representatives, however, had not asked for Department of Finance direction on severances and had not taken any action on severances for EDFUND executives.

Despite the controversy about the EDFUND board's violations of the Open Meeting Act and the board's unilateral consideration of severance agreements, the Department of Finance representatives also preemptively told the Commission representatives that they would consider the removal of directors from the EDFUND board to devalue the asset. Again, the Commission representatives had not indicated to the Department of Finance that the Commission was considering removing the EDFUND directors.

Commission staff is unclear about the source of information on which the Department of Finance relied to reach its conclusions about the devaluing of student loan guarantee program assets, since the Department of Finance did not consult with the Commission or Commission staff.

The Department of Finance's decision-making under its SB 89 authority without consulting the Commission is not solely a procedural point, but, as illustrated by the Department's preemptive warning not to remove the Directors of the EDFUND Board even after their violations of the Open Meeting Act and insistence on awarding severance benefits to EDFUND executives, raises substantive concerns that potentially devalue student loan guarantee program assets.

A Restrictive Interpretation of SB 89 Authority Should be Implemented to Avoid Conflict with Federal Law

As previously noted, federal law requires a single state agency to administer the FFEL Program when a state program is designated by the United States Department of Education. (See 20 USC §1078(b)(K); 34 CFR §682.401(b)(16).) Therefore, unless the Department of Finance exercises its authority under SB 89 with caution, it risks intruding on the authority and responsibility imposed by federal law on the Commission. Such an intrusion could violate federal law, and would be overridden by the Supremacy Clause in the United States Constitution, which establishes the primacy of federal law over conflicting state law. (United States Constitution, Article VI, clause 2.)

An overbroad application of SB 89 authority by the Department of Finance, causing the Commission's administration of the FFEL Program to violate federal law would devalue the State's student loan guarantee program assets. Thus, the Department of Finance

should exercise its authority under SB 89 restrictively, and ensure that it consults fully with the Commission before acting, since the Commission, and the Commission only, is designated by the United States Department of Education, to act as a student loan guarantee agency.

However, the Commission under California law is subject to the requirement that it comply with an official Department of Finance action under SB 89 even if the Commission were to disagree with the action. The California Constitution prohibits an administrative agency from declaring a statute unenforceable on the grounds of unconstitutionality unless an appellate court has made a determination that the statute is unconstitutional. (California Constitution, Article III, Section 3.5.) The Commission is bound to comply with SB 89, therefore, until an appellate court issues a decision determining SB 89 to be unconstitutional.

From a legal perspective, therefore, if the Commission were to conclude that its duty under federal law conflicts with a decision by the Department of Finance, the conflict must be resolved by a lawsuit.

Alternatively, an administrative resolution is possible. If the Commission were to disagree with a decision by the Department of Finance, it could seek guidance on that decision from the United States Department of Education, which is responsible for the administration of the FFEL Program at the federal level. If USDE responds, the Commission would be better informed about its next steps.

Accordingly, Commission staff has drafted the accompanying resolution based on the premise that the Commission has, and will exercise, full authority under both federal and state law to administer the FFEL Program as the student loan guarantee agency designated by the United States Department of Education. To the extent that the Commission concludes that a decision by the Department of Finance under SB 89 results in a conflict that causes the administration of the FFEL Program to be inconsistent with federal law, the Commission will consult with the United States Department of Education.

Responsible Persons: Ed Emerson, Chief
Federal Policy & Programs Division

Keri Tippins
General Counsel

DRAFT

Resolution of the California Student Aid Commission

Whereas, the California Student Aid Commission is committed to our mission to make education beyond high school financially accessible to all Californians.

Whereas, in today's economic climate, it is an undeniable fact that many students seeking a post-secondary education rely on loans to make the dream of a post-secondary education a reality.

Whereas, since 1978, the California Student Aid Commission has served as California's student loan guarantee agency under the Federal Family Education Loan (FFEL) Program.

Whereas, federal law authorizes a state student loan guarantee agency to administer the FFEL Program through a nonprofit organization, but is explicit in requiring the guarantee agency to have and to exercise full authority over, and have accountability for, the nonprofit organization.

Whereas, in 1996, authorizing legislation permitted the Commission to create an auxiliary organization, EdFund, as a nonprofit public benefit corporation and further required the Commission to maintain its responsibility for financial aid program administration, policy leadership, program evaluation, and information development and coordination, if it administered the FFEL Program through an auxiliary organization.

Whereas, the Commission limited the purposes for which EdFund existed, and correspondingly limited EdFund's authority to operating "exclusively for the benefit of, to perform the functions of, and to carry out the purposes of said Commission."

Whereas, the enactment of Chapter 182 of the Statutes of 2007 (Senate Bill 89) ("SB 89") and the implementation of SB 89 have further complicated the Commission's administration of the FFEL Program, including the issue of governance over the auxiliary organization.

Therefore Be It Resolved that the California State Aid Commission continues to administer its responsibilities as the student loan guarantee agency designated by the United States Department of Education under the FFEL Program consistent with the federal and state law and the mission of the Commission.

Resolved Further that the Commission has, and will exercise, its full authority under both federal and state law to administer the FFEL Program as the student loan guarantee agency designated by the United States Department of Education.

Resolved Further that to the extent that the Commission concludes that a decision by the Department of Finance under SB 89 results in a conflict that causes the administration of the FFEL Program to be inconsistent with federal law, the Commission will consult with the United States Department of Education.