5.4

Information Item

California Student Aid Commission

EDFUND President's Report

Attached is the president's report prepared by Becky Stilling for the August 16 EDFUND Board of Directors meeting. Interim President Sam Kipp will provide any available updates to the information it contains in his oral presentation to the Commission.

Recommended Action: For information only. No action is required.

Responsible Staff: Sam Kipp,
Interim EDFUND President

President's Report to the Board of Directors

August, 2005

As I write this, our July statistical reports are not yet available, but we'll be sure to update you at our meeting on the 16th. In the meantime, here are the numbers for June.

Overall, loan volume growth eased off somewhat in June. New Stafford subsidized loan volume grew 5.8% and Stafford unsubsidized grew 5.3%. PLUS volume – where we've seen our strongest growth in recent months – grew 47.1% (although PLUS still makes up just 12% of our total volume). Overall, new loan volume grew by 9.3%, slower growth than we've seen yet this fiscal year. As I've reported to you separately, we are seeing after-effects in the marketplace from the negative publicity EDFUND experienced earlier this year.

Consolidation loans continue to lag considerably behind last year. This volume is typically volatile from year to year, and several of our lender partners have told us they expect it to take weeks, perhaps months, to process all of the consolidation applications they received during the last minute rush to beat the July 1 interest rate increase. As a result, it's difficult to predict where this number will fall at the end of the fiscal year.

Default claims continue to run about 40% higher than last year. This is an unwelcome but not unexpected development. We have booked a tremendous amount of new loan volume over the past five years; as that volume begins to mature, claims will inevitably rise in absolute terms. The key performance metric here is not the number of claims filed, but rather our default rate. While we anticipate an increase in our annual default rate, on a percentage basis it will be much less than the increase in claims.

One of the ironies of the FFEL Program's financial model is that, while an increase in claims is nothing to cheer over, it does give our collections staff a larger portfolio to work. As a result of both that reality and a number of recent initiatives undertaken by our Default Management Division, collection recoveries grew substantially once again in June. Over, our fiscal year-to-date growth from last year to this one is 33%. Note that this growth will likely taper off next year as we put more focus on loan rehabilitation – which has a 12-month lag time – as a collections strategy.

1. Business Planning Initiatives

<u>Budget & business plan</u>: As you know, in view of the other activities that consumed so much of Financial Operations staff's time earlier this year, we have agreed to delay consideration of the annual budget and business plan slightly this year. At our upcoming meeting, staff will present a preliminary budget for your consideration and conditional approval, with a final budget to be

presented and approved at the Board's November meeting. The budget proposal will provide a basic structure as well as performance targets.

2. Federal Issues

Voluntary Flexible Agreement (VFA): EDFUND staff have largely completed the preparatory work necessary to begin negotiations with the U.S. Department of Education on a new VFA that would preserve our basic business model, but add new targets and rates for performance achievement. The proposal focuses on three components -- shared claim savings, collections and early withdrawal counseling. EDFUND and Commission staff recently spoke via conference call with Department staff to confirm the outline of our proposal and identify key points for negotiation. Department staff promised to study the proposal outline and give us a reaction before we proceed further. The Department has indicated it wants to move forward with negotiations soon.

We are currently examining two important questions that need to be answered as we move forward with this process. First, we need to determine the performance targets we want to use in our proposal. Second, we need to model the potential impact on our VFA proposal if the Department holds firm in its current stance of mandating collection of the guarantee fee under all VFAs. It will be very important to understand the effects a mandatory guarantee fee might have on our entire financial structure.

Reauthorization issues: Reauthorization of the Higher Education Act appears to be gaining momentum once again. The House Committee on Education and the Workforce approved its proposal for reauthorization (HR 609) on July 22. Key FFEL Program provisions in this proposal include:

- Changing the discretionary 1% guarantee fee to a mandatory 1% "federal default fee"
- Reducing guarantor reinsurance on defaulted loans from 95% to 93% (lender and exceptional performer reinsurance would also be reduced 2% each)
- Capping collections retention at 18.5%, and allowing guarantors to retain only 10% on loans collected through consolidation
- Reducing the time required for a borrower to complete rehabilitation of a defaulted student loan from 12 to 9 months

The House Committee's counterpart in the Senate is still developing its version of reauthorization legislation, with action expected there in September.

The Commission and EDFUND recently formed a federal policy workgroup to facilitate the tracking of these issues and manage our new federal relations vendor, Mayer Brown. EDFUND staff have spent a substantial amount of time in recent weeks educating Mayer Brown staff on the FFEL Program, existing industry relationships, past legislative strategies, and how different current issues affect the Commission and EDFUND'S interests.

3. Company Improvement Initiatives

Job families project: This project remains on target for initial rollout to staff in September. The executive management team is currently reviewing and fine-tuning the "leveling" process by which current jobs are placed within the new job families that will be established for all existing and future EDFUND positions.

Information security risk assessment: Staff will provide you with a high-level walk-through of the findings in this assessment, and our responses to them, in the meeting. As you'll recall, EDFUND and CSAC staff unanimously selected Risk Management Alliance (RMA) as the vendor for this assessment. RMA is an alliance between Foley & Lardner LLP and VeriSign Corporation, both well-established and widely respected firms in this field. The assessment process was vigorous and was carried out with a great deal of integrity. FYI, this project also includes an assessment of the Commission's information management systems.

Audit activities: The Internal Audit Department recently completed three reviews in the areas of Default Claims Processing, Internal Collection Activities, and Compliance with EDFUND Policy 009, "Employment of Applicants and Employees with Guaranteed Student Loans." Internal Audit staff are currently evaluating our internal controls over manual borrower and loan updates, data center operations, cashiering and specialty claim processing.

4. **Other Initiatives & Issues**

EDSHARE For Educational Institutions: A variety of follow-up and assessment activities related to this program continue. Planning is well underway for the Forum On Successful Student Borrowing, a symposium we are hosting for financial aid staff that will focus on successful default prevention and borrower education strategies. The Forum will be held in Phoenix in mid-November. In addition, the annual review process for renewing EDSHARE grantees continues, and we are moving forward to conduct a series of case studies of 2002 and 2003 grantees for purposes of evaluation and identification of successful default prevention strategies that EDFUND and/or other schools may be able to replicate.

Space planning project: As you know, the lease at our current headquarters location will expire in late 2007. In order to conduct a thorough procurement that allows time for a build-out, should an alternate site be selected, we have been working steadily on identifying viable space options in the Sacramento area. We are currently progressing through the RFP process with proposals being received from a variety of Sacramento area developers and property owners. Recently, from a list of 10 potential facility sites, the field was narrowed to four options, including an option and proposal from our current landlord. We expect to conclude the RFP process and begin direct lease negotiations with one or more developers/property owners in September.

Commission Support Activities: Significant recent Commission support activities include:

- The Tier One Help desk project was completed in June. This project utilizes EDFUND Help Desk staff for initial intake of all customer calls, referring them to Commission Help Desk staff only when specialized assistance is required.

- EDFUND Technology staff have proposed an outsourced solution for the Interactive Voice Response project. This system will enable the CSAC Call Center to manage inbound calls more effectively during peak seasons, in order to reduce the number of abandoned calls and improve customer service.

- Work continues on the GPA Image Optimization Analysis project, which is seeking to put more control in the hands of students regarding the completion of their grants application and to expedite the processing of GPA verification forms.

- The Grant Delivery System (GDS) Hosting Project – which would move GDS from the Teale Data Center to EDFUND's Data Center -- is awaiting Department of Finance approval. This project promises to reduce cost and provide improved flexibility in the management of GDS.

5. Customer Feedback

Normally this space contains feedback our staff have received from customers about EDFUND service. Instead I though it important to summarize for you some of the feedback our client services staff are receiving from customers and prospects. While we continue to add new loan volume, a number of our school contacts have expressed concern about recent developments. In particular, they cite:

- negative publicity about EDFUND
- the use of Student Loan Operating Fund dollars to support the Cal Grant Program
- concerns about burdensome state oversight affecting service levels, and
- concerns about the Commission's action to remove Board members.

Please let me know if any of you would like top personally review the actual reports from our Client Services staff.

6. Conclusion

This is a challenging time for both EDFUND and the Student Aid Commission. The choices are becoming harder and the stakes higher. EDFUND staff stand ready to support you as we move through these challenges together. Please don't hesitate to contact me at any time to discuss any of these issues, or the challenges still ahead.