

Action/Information Item

California Student Aid Commission

September 5, 2008 Letter from the Director of Finance
Purporting to Overturn Certain Actions Taken By the Commission
At its September 2008 Regular Meeting

The United States Department of Education has designated the Commission as the state student loan guarantee agency for California under the Federal Family Education Loan Program (FFEL Program). The Commission administers the FFEL Program through a nonprofit public benefit corporation, EdFund, which the Commission established in 1997. Federal law explicitly requires the Commission to have and to exercise full authority over, and have accountability for, its nonprofit organization, including the setting of policies for the FFEL Program administration. (See (34 CFR §682.401(b)(16).)

At its September 4-5, 2008 meeting, the Commission acted to strengthen its oversight of its auxiliary organization, EdFund. Recent activity by EdFund had demonstrated that long-standing issues in the Commission's ability to effectively oversee EdFund had not been resolved. Among the issues raised at the September meeting were the following:

- Execution by the EdFund President of a \$5 million contract without the knowledge of the EdFund Board or Commission (September 2008 Tab 3)
- Issuance of a Request for Proposal for a Multimedia Public Awareness Campaign espousing policies that the Commission had not adopted or authorized contrary to the terms of the Governance & Monitoring Policy (September 2008 Tab 4)
- Execution by the EdFund President of other questionable contracts that encumbered State funds (September 2008 Tab 5)
- Pursuit of a Federal Default Fee Strategy that was inconsistent with federal law (September 2008 Tabs 1 and 6)
- The EdFund Board's insistence on pursuing, to the point of violating the Open Meeting Act and ignoring conflict-of-interest issues, severance agreements, or change-in-control agreements, drafted by EdFund executives for themselves in anticipation of the sale of state student loan guarantee program assets. (September 2008 Tab 8)

These actions, taken in most instances without the knowledge of the EdFund Board of Directors or the Commission, or against the express direction of the Commission, established that a two-tiered governance structure left insufficient accountability and direction between the Commission and the EdFund Executive management team. As a result the Commission acted to strengthen its supervision and oversight of its auxiliary organization through the removal of the EdFund Board and the replacement of those

Directors with the individuals that are ultimately responsible and liable for the actions of EdFund and the Commission. (See Tabs 9 and 10 of the September 2008 Commission Agenda).

On September 5, 2008, during a public comment period, staff from the Department of Finance read a letter from Director of Finance Michael Genest in which he issued a "statement of disapproval" on agenda item 8 (executive compensation) and items 9 and 10 (removal of the EdFund Board of Directors and replacement of those individuals with the Commissioners) pursuant to his understanding of his authority under Senate Bill 89.

Because Mr. Genest's letter was read during the public comment period of the September Meeting, and was not a noticed agenda item, this item is being brought forward for the Commission's discussion.

Responsible Persons: Keri Tippins
General Counsel



DEPARTMENT OF
FINANCE
OFFICE OF THE DIRECTOR

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September 5, 2008

Mr. Peter Hankwitz
Chair, Student Aid Commission
P.O. Box 419028
Rancho Cordova, CA 95670

Dear Chair Hankwitz:

September 4 and September 5, 2008 Commission Actions Concerning EdFund

This is to inform you that I do not approve the Student Aid Commission's approval of agenda items 8, 9, and 10 taken at the commission's meeting yesterday. These items act to remove and replace board members for the commission's auxiliary organization, EdFund, and change compensation policy. The replacement of these members at this point in time is inconsistent with protecting and maximizing the value of the state's student loan guarantee program. Pursuant to Education Code section 69521.5, subdivision (c)(3), actions of the commission affecting the state student loan guarantee program shall be effective only upon my approval. Thus, my statement of disapproval acts to make these commission actions of no force or effect.

The Legislature granted this approval authority to me without changing its prior determinations that the commission should act as the State's student loan guarantee agency, that the commission could establish an auxiliary organization for the purpose of providing operational and administrative services for the student loan guarantee program, and that this auxiliary organization would be under the commission's oversight. I have recognized and continue to recognize that my oversight responsibility is for the sole purpose of determining whether actions taken by the commission, including its oversight of its auxiliary organization, are consistent with protecting and maximizing the value of the state's student loan guarantee program.

On Tuesday, September 2, I advised you of my intention to undertake an independent review of the many allegations of impropriety cited by commission staff in the agenda package for the commission's September 4 & 5 meeting, as well as the allegations in your letter to me of August 29, and those presented to me by the commission's auxiliary organization, EdFund. These allegations raise significant questions about the effect on the value of the student loan guarantee program of actions taken by both the commission and its auxiliary organization. I proposed that the commission postpone the related agenda items for a month until the Office of State Audits and Evaluations could complete that independent review. Even though the commission did not honor this proposal, it remains my intention to obtain independent review of the allegations of impropriety that have been brought to my attention.

With regard to the characterization of the Department of Finance's (Finance) role pursuant to SB 89 in certain of the staff reports attached to the agenda for the September 4 & 5 commission meeting, you should know that my staff has routinely advised commission staff that Finance

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staff prefers to seek my approval only following a commission action, rather than intrude on day-to-day commission activities or the commission's routine oversight of its auxiliary organization, EdFund. On occasion, Finance staff has provided guidance as to whether my approval of a proposed action was likely to be forthcoming. On other occasions, Finance staff has met with EdFund representatives to obtain information about the effect that certain proposed actions would have on the value of the state's student loan guarantee program. I am extremely disappointed that this minimalist oversight approach has not been recognized in the commission staff's reports. Regardless of whether Finance's approach is appreciated or understood by commission staff, it remains my statutory obligation to determine whether to approve commission actions as consistent with the Legislature's intention to maximize the value of the student loan guarantee program.

To assist commission staff in understanding how I have and will continue to exercise my legislatively authorized approval power, I provide the following: I encourage the commission's oversight of EdFund in compliance with the commission's statutory obligations. I also encourage EdFund's cooperation with the commission, in recognition that, as an auxiliary organization, the organization's purpose is to provide for the *commission's* participation in the Federal Family Education Loan Program. That said, it is my position that the value of the state's student loan guarantee program will be improved if the commission recognizes that the Legislature's purpose in establishing an auxiliary organization was to permit a level of flexible operations not available to a government entity in order for the guarantee program to be effective in a highly competitive market place. This has value to the state's student loan guarantee program, and should not be compromised. I do not suggest that the commission fail in its exercise of oversight responsibility. I propose that this oversight be exercised with recognition of the reason EdFund was authorized by the Legislature.

Further, I want to express my opinion, which I have communicated to both commission staff and staff of EdFund in the past, that both organizations should dramatically improve communication and cooperation with one another and with Finance. I encourage commission staff to consult with Finance staff to determine the likelihood of whether certain decisions, if made by the commission, would be approved. As noted above, I do not recommend that commission staff or staff of EdFund seek Finance's input on day-to-day operations of their respective organization.

If you have any questions about my determination which results in the commissions actions as to items 8, 9, and 10 having no force or effect, please contact Finance's Chief Operating Officer, Fred Klass, at (916)-445-4923.

Sincerely,



Mike Genest
Director

cc: Ms. Sally Furay, Chair, EdFund Board of Directors
Dr. Sam Kipp, President, EdFund
Ms. Diana Fuentes-Michel, Executive Director, Student Aid Commission