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Action/Information Item

California Student Aid Commission

Consideration of Revised Commission Policy on EDFUND Incentive Compensation Plans [Item 12 of BSA Recommendations – Status Update]

The Bureau of State Audits (BSA) April 2006 report found that the Commission's policy regarding EDFUND Executive Incentive Compensation is flawed. The current policy allows EDFUND's Executive Management Team to receive substantial bonuses even with an operating deficit and specifically excludes certain loan program revenues and expenses. BSA recommended that the Commission do the following:

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

The Commission process established in response to BSA's recommendations provided that the Commission would ask the EDFUND Board to review, with its management, all aspects of the incentive compensation policy approved by the Commission in August 2002, and propose appropriate adjustments to the Commission's Personnel, Evaluations & Nominations Committee and the Commission for their review and approval.

The EDFUND Board Personnel and Nominations (PEN) Committee has met numerous times with Watson Wyatt, the compensation consulting firm engaged to assist the EDFUND Board with the review of existing executive salary policy and process. Enclosed is the resulting draft policy, along with the current Commission Policy for your reference.

However, CSAC staff, including the Executive Director who is an ex officio Board Member, was excluded from the PEN Committee meetings during which Watson Wyatt presented its recommendations. On November 17, 2006, CSAC staff participated in a teleconference with Ann Costelloe, Watson Wyatt Senior Consultant, to better understand the rationale and process undertaken by EDFUND in recommending changes to the policy. There has been insufficient time for CSAC staff to thoroughly analyze the policy to ensure that the State's interests are protected and appropriate. As a result, CSAC staff cannot recommend action until all of staff's questions and concerns are sufficiently addressed.

Recommended Action: No action at this time.

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

DRAFT REVISION

CSAC POLICY STATEMENT AND GUIDELINES MEMORANDUM

		CONTROL NUMBER
SUBJECT: EDFUND Incentive Compensation Plans		EFFECTIVE DATE
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 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 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 employees.

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

A. Number of Plans

There are three non-executive incentive compensation 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.
- **COLLECTION COMMISSION Plan for Internal Collection Staff:** This plan awards incentive compensation based on performance against established collection net revenue targets.

The EDFUND Board of Directors and the Commission's Executive Director are responsible for approving incentive compensation plans and any subsequent changes to the plans. Incentive compensation plans that are specified in the Operating Agreement will be reflected in the EDFUND budget as a part of total wages and salaries.

B. Company Performance Component of EDSHARE Plans

At fiscal year end, the Commission will assess the percentage of accomplishment EDFUND has achieved toward the high-level organizational goals as contained in the Business Plan that is approved by the EDFUND Board and the Commission in accordance with the provisions 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 reports his/her recommendation to the Commission Chair who either concurs or modifies 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 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. The decision of the Commission is final.
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 incentive compensation generally will require that a year end net operating surplus for the loan program be a threshold for incentive compensation payment, excluding any non-loan program expenditures.

The Commission places responsibility to determine the amounts of executive incentive compensation payment with the EDFUND Board or its designated committee. 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.

Approval Process

1. At fiscal year end, the EDFUND Board provides the Executive Director and the Commission Chair with documentation that details the overall performance of EDFUND and an assessment of the individual performance of EDFUND's President.
2. The EDFUND Board also recommends to the Executive Director and to the Commission Chair the proposed incentive compensation amount for the President and the total incentive compensation pool amount for the Executive Management Team.
3. The Executive Director 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 to the Commission Chair.
4. The Commission Chair evaluates the Board's report and the Executive Director's report and determines whether or not the incentive compensation amounts proposed by the EDFUND Board are appropriate.
5. The Commission Chair either concurs or modifies the incentive compensation amounts and communicates his/her decision to the EDFUND Board.
6. If either the Executive Director or the EDFUND Board disagrees with the decision rendered by the Commission Chair, one or both may request a closed session review by the Commission. This review would be performed at the next scheduled meeting of the Commission. The decision of the Commission is final.
7. 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.

CURRENT POLICY

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.
- EDSHARECOLLECT 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



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.