

**Action/Information Item**

***Personnel, Evaluation and Nominations (PEN) Committee***

Consideration of EDFUND Executive Compensation Policy [Item 11 of BSA  
Recommendations – Status Update]

---

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 it comply with its own 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 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 comprehensive Executive Compensation Policy developed by EDFUND staff.

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 the policy. There has been insufficient time for CSAC staff to thoroughly analyze the draft 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

# 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 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 75<sup>th</sup> 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 generally 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.

### ***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 75<sup>th</sup> 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 in 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 and must be approved in advance by the Board of Directors. Any severance award will follow the provisions of the EDFUND severance policy
- ◆ 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 75<sup>th</sup> percentiles of the comparable market data. A summary of the analysis will be provided to the EDFUND Executive Committee for each individual executive position.

### ***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. In no case will the Commission Chair recommend a higher incentive compensation amount than is approved by the Board of Directors.

**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, and any explanation or rationale for each decision for each executive.

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.

## Appendix – Peer Group

Non-Profit Comparators <sup>(1)</sup>					
Organizations	NTEE Code	Description	Assets (Millions)	Revenue (Millions)	
Access Group Inc	W60	Financial Institutions, Services (Non-Government Related)	\$136	\$190	
Access To Loans For Learning Student Loan Corporation	W60	Financial Institutions, Services (Non-Government Related)	\$34	\$43	
American Student Assistance	W60	Financial Institutions, Services (Non-Government Related)	\$35	\$79	
Brazos Higher Education Authority Inc	B82	Scholarships, Student Financial Aid Services, Awards	\$135	\$174	
Educational Credit Management Corporation	W60	Financial Institutions, Services (Non-Government Related)	\$175	\$137	
Educational Funding of the South	W60	Financial Institutions, Services (Non-Government Related)	\$183	\$151	
Great Lakes Higher Education Guaranty Corporation	B82	Scholarships, Student Financial Aid Services, Awards	\$52	\$105	
Nebraska Student Loan Program Inc	B82	Scholarships, Student Financial Aid Services, Awards	\$44	\$31	
Northwest Education Loan Association	W60	Financial Institutions, Services (Non-Government Related)	\$13	\$20	
South Carolina Student Loan Corporation	W60	Financial Institutions, Services (Non-Government Related)	\$261	\$132	
Texas Guaranteed Student Loan Corporation	W60	Financial Institutions, Services (Non-Government Related)	\$218	\$140	
United Student Aid Funds Inc	W60	Financial Institutions, Services (Non-Government Related)	\$453	\$391	
<b>Number of Non-Profit Comparators-12</b>					
			25th Percentile	\$42	
			Median	\$136	
			Average	\$145	
			75th Percentile	\$192	
EdFund (2006-2007 Proposed Budget) <sup>(2)</sup>	W60	Financial Institutions, Services (Non-Government Related)	\$46	\$133	
			Percentile Rank	30%	
				47%	
Publicly Owned Comparators <sup>(3)</sup>					
Organization	Ticker	Description	Assets (Millions)	Sales (Millions)	Co
Student Loan Corp	STU	N/A	\$25,988	\$1,352	
<b>Notes:</b>					
<sup>(1)</sup> Financial data for not-for-profit comparators gathered from 990 Forms					
<sup>(2)</sup> Information obtained from CSAC/EdFund Operating Fund spreadsheet provided by the client					
<sup>(3)</sup> Financial data for publicly owned comparators gathered from Standard & Poor's Research Insight - to be used for informational purposes only.					

### Published Survey Sources

Survey	Scope	For-Profit	Not-For-Profit
2005 Mercer Exec Comp	Finance/Banking: Assets less than \$25B (cuts range from \$5-\$13.3B)	x	
2005 Mercer Exec Comp	Government/Non Profit: Operating Expenses/Budget less than \$400M		x
2005/2006 WWDS Top Mgt.	Total U.S. FTE Banking & Finance (cuts range from 433 FTE - 1248 FTE)		x
2005/2006 WWDS Top Mgt.	Supersector: Financial Services (regression @\$46M assets)	x	
2005/2006 WWDS Top Mgt.	Sector: Banking & Finance-All Organizations Assets (cuts range from \$5.2B -\$25B)	x	
2005/2006 WWDS Top Mgt.	Sector: Banking & Finance (regression @ \$46M assets)	x	
2005/2006 WWDS Financial Institutions Comp.	Total FTE 500-2,999 (cuts range from 784 FTE - 1472 FTE)	x	
2005 Proprietary Source Financial Services Industry Exec Comp	Total Revenue (regression @\$133M)	x	