



CALIFORNIA STUDENT AID COMMISSION

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EXECUTIVE DIRECTOR**

**TESTIMONY BEFORE
SENATE BUDGET
SUBCOMMITTEE NO. 1 ON EDUCATION**

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Good afternoon, Chair Scott, Senators Vasconcellos and Margett:

The mission of the California Student Aid Commission is to “make education beyond high school financially accessible to ALL Californians.” That mission is no less important today than when the Commission was established in 1955 as the State Scholarship Commission. The State Scholarship program evolved over time into the Cal Grant program, which today provides grant assistance to all three segments of public higher education in California, as well as to private and proprietary institutions. Since 1977, the Commission also has served as the guarantee agency for the federal student loan program. Today, the Commission continues as the primary guarantee agency for California through its non-profit loan servicing auxiliary, known as EDFUND.

In addition to its primary responsibilities in administering the State’s grant program and federal loan guarantee functions, the Commission has directly financed \$52 million in public benefits from revenues generated by the federal student loan program, officially known as the Federal Family Education Loan (FFEL) Program. These benefits include the following: funding for a Cal Grant public awareness campaign; funding for an outreach program known as the California Student Opportunity and Access Program or Cal-SOAP, which will serve an estimated 113,900 students in 2003-04; and this year for the first time, grant funds for high school and campus-based outreach.

These outreach and awareness programs are funded by revenue available in the federal student loan program, expenditures that otherwise would have come from the General Fund.

Attachment 1 provides you with a display of those benefits over the past three years.

As you can see, today the Commission's administrative budget is funded entirely by revenue from the Student Loan Operating Fund ("Operating Fund"). The Governor's proposed budget proposes no changes to the Commission's administrative budget. The overall administrative budget for 2004-05 is \$12.6 million, funded entirely by the Operating Fund. The Governor's program proposals are primarily directed at controlling the growth anticipated in the Cal Grant program.

As you know, the Cal Grant program was redesigned in 2000. Prior to the initiation of the new Cal Grant program, more than 163,000 new and continuing students had access to a Cal Grant award. Today, nearly 248,000 California students have access to a Cal Grant to help fund their higher education goals (see attachments 2 and 3). These students attend 386 participating California institutions statewide. The number of first-time recipients increased from 30,000 graduating high school seniors in 2000-01 to more than 60,000 last academic year. April is decision month for many college and university students. The Commission will have preliminary estimates of this year's Cal Grant eligibility pool in the next two weeks. We are now in the process of communicating with approximately 12,000 students who have submitted applications that were incomplete or appear to have submitted incorrect data. We are working with Superintendent O'Connell to communicate directly with high school principals to encourage them to help in the correction process.

In this tough fiscal year when student fees are proposed to be increased at the state's public colleges and universities and no significant increase in federal student financial aid dollars is expected next academic year, the Commission is committed to maintaining the integrity of the Cal Grant program, both in the Entitlement and Competitive programs -- specifically the value of the awards and the populations served.

The Administration proposes a 10% reduction in the maximum allowable income to determine student eligibility for both Cal Grant Entitlement and Competitive awards, a move that would result in a projected \$11.2 million in budget savings in 2004-05. Based upon the 2003-04 entitlement award pool, approximately 4,450 students would be denied Cal Grant awards if this reduction is enacted. In addition, the Administration's proposal would reduce the eligible pool for the competitive program by approximately 19,000 students. These students are among those most in need financially. For example, in 2001-02, the vast majority - or 81 percent - of the Cal Grant competitive award recipients were from families with annual incomes below \$24,000. In 2002-03, that percentage had grown to 84 percent.

In addition, the Administration proposes to "decouple" Cal Grant awards from the systemwide fees at the California State University and the University of California, which the Commission believes will widen the funding gap that already exists for up to 90,000 CSU and UC students who qualify for Cal Grant awards. The Administration also proposes to reduce the maximum Cal Grant award for students at non-public postsecondary institutions from \$9,708 to \$5,482 per year, representing a 44 percent decrease in the value of the award. This decrease would affect approximately 9,700 students.

In light of this projected impact on students, the Commission recommends the restoration of full funding to the Cal Grant program in the 2004-05 State Budget Act. The Commission believes that the Cal Grant program is a critical investment in California's future and will result in larger numbers of educated citizens who enter the workforce prepared to excel in whatever occupation they choose.

The Commission will be releasing a report shortly that demonstrates the success of this investment. The report follows a cohort of 100,000 college financial aid applicants in California. The report reveals that regardless of the other factors that may influence a student's progress toward their degree, receiving a Cal Grant makes a significant difference in a student's ability to persist in college. Specifically, the study shows that first-time freshmen Cal Grant A and B recipients have a higher rate of re-enrollment than applicants who sought but did not get a Cal Grant, or than those who did not apply. In all, 96.5% of 1998-99 freshmen Cal Grant A recipients in the study re-enrolled in 1999-00, as did 93.1% of Cal Grant B recipients.

On a personal note, I want to share with you that you are looking at a Cal Grant B recipient. So, I am an example of that investment. I graduated from Loyola Marymount University after receiving a Cal Grant B award for four years. My parents were low-income. I was the first in my Mexican-American family to attend a university. Federal and state grant aid enabled me to achieve my dream of a college education. Without the Cal Grant, I would have been unable to afford the cost of a university education. The education I received enabled me to pursue my goal of public service.

Today, tens of thousands of California students are trying to achieve their college dreams, and they rely on both grant and loan aid to finance their education.

As I mentioned earlier in my testimony, the Commission has guaranteed student loans in California for more than a quarter century. The Commission established EDFUND in 1997 as a non-profit, public benefit auxiliary to administer the Commission's participation as guarantee agency in the federal student loan program. The Commission adopted this change in administrative and governance structure in response to changes in the federal student loan program.

These changes required guarantee agencies to be competitive with other guarantee agencies and with what is called the Direct Lending program, where students borrow directly from the federal government. Furthermore, as a non-profit, public benefit corporation of the Commission, EDFUND is charged with ensuring that ALL students have equal access loans to help reduce students' unmet financial need, regardless of where a student attends college.

Unlike other guarantee agencies that may be owned by for-profit entities, the Commission provides low-cost loans and superior services to student borrowers and institutions through its auxiliary, EDFUND. The Commission has led the industry by initiating and maintaining the waiver of its loan guarantee fee – saving student borrowers more than \$163 million since 1996.

The point here is that the Commission and EDFUND do not see students as “good paper” or “bad paper,” nor do we believe that the only way to succeed is to selectively market to certain student populations. Consistent with the Commission's mission to serve ALL students, the Commission and EDFUND are committed to helping students achieve their dream of a college education. It is the obligation of the Commission and EDFUND to help students obtain the resources to do so.

EDFUND provides services to students and institutions in and outside the State of California. It is the second largest guarantee agency in the country, serving more than 4,600 institutions nationally, of which 1,285 are in California. The number of students attending school in California with the aid of a Commission-guaranteed loan totaled 355,548 as of the end of the 2002-03 federal fiscal year (see attachments 4 and 5).

As I have indicated earlier, EDFUND's success has resulted in a significant balance of revenue in the Operating Fund. The federal Higher Education Act requires the Operating Fund to be used first for administration and activities directly related to the FFEL Program. The only other authorized use for the Operating Fund is for other student financial aid-related activities selected by the guarantee agency.

It is important to note that a large portion of the surplus revenue can be attributed to the implementation of the Commission's Voluntary Flexible Agreement, signed in 2001. Known as the VFA, this agreement established certain arrangements between the Commission and the U.S. Department of Education. This agreement has resulted in an annual payment from the federal government for performance objectives achieved in default aversion and collection management. It is important to highlight that the VFA is subject to cancellation at a 90-day notice. Furthermore, the VFA, as well as the base guarantee agency funding (administrative fees and collection revenue) are subject to review, change and cancellation in the pending Reauthorization of the Higher Education Act.

The Commission has reviewed the Legislative Analyst's recommendations regarding use of the surplus in the Operating Fund. The Commission is opposed to the Legislative Analyst's recommendation to redirect \$66 million in 2004-05 from the Operating Fund to financial aid offices at the University of California and California State University.

The Commission believes that, after the appropriate investments have been made to the loan program, any redirections from the Operating Fund should provide a direct benefit to students.

I would note that Legislative Analyst herself cautioned that any redirection would need to be looked at annually due to uncertainty in federal policies regarding revenue retention by guarantor agencies, such as the Commission. The Commission recommends that any redirection from the Operating Fund in 2004-05 be short-term in nature.

As the Operating Fund balance has increased over the past few years, the Commission deliberated how to best use these funds to provide additional public benefits to students and institutions, improve services, and invest in the loan program. We have provided for your information copies of the Capital Utilization Plan (see attachment 6) adopted by the Commission to designate uses of the Operating Fund over the next five years.

As the state's guarantee agency, the Commission's fiduciary concern in the administration of the loan program is to sustain and ensure the viability of its auxiliary organization. If the Operating Fund is drained, the State will seriously jeopardize the ability of the Commission to provide future loan program revenues and, in turn, seriously threaten the Commission's continued ability to provide public benefits.

In closing, I would like to leave you with three key thoughts:

1. The Commission is committed to finding ways to maintain the integrity of the Cal Grant program.
2. The Commission is committed to positioning itself and EDFUND as the long-term, self-sustaining guarantor of college access and affordability in California.
3. The Commission will continue to invest student loan revenues to grow the loan business to serve our school customers and to provide greater student and public benefits.

I thank you for the opportunity to testify before the Committee today, and I look forward to working with you and the Assembly on a final budget agreement. I am available for any questions that you may have.

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What is the Voluntary Flexible Agreement?

HISTORY

The California Student Aid Commission (CSAC) is one of four federal loan guarantee agencies nationwide that currently participate in a Voluntary Flexible Agreement (VFA) with the U.S. Education Department (USED). Authorized by Congress in 1998, a VFA is an agreement between a guarantor and the USED which amends the standard guarantee agency agreement for administration of the Federal Family Education Loan (FFEL) Program.

The purpose of a VFA, (CSAC's was signed in 2001), is to provide guaranty agencies with the flexibility to implement new business practices by waiving or modifying some of the requirements under the Higher Education Act and federal regulations. All of the four existing VFAs seek to improve default aversion and increase the financial incentives for preventing defaults, but they each do so in a unique way. As part of the VFA, CSAC/EDFUND administers programs that focus on improving default prevention and loan collection performance with the opportunity to earn a new fee for reducing the default claims paid by the federal government and also to retain higher income from loan collections.

CSAC/EDFUND has developed numerous innovative programs for student borrowers and institutions which are designed to avert default rather than focus on post-default collections. Some of these programs include individualized school assessments to help them improve their default prevention strategies; web-based systems that help institutions track students throughout repayment of their loans; and online tools for students that help with financial planning and debt awareness. Additionally, EDFUND counsels borrowers who have withdrawn from school, provides guidance on flexible repayment options, and distributes numerous free publications and videos geared toward responsible loan repayment and avoiding default.

BENEFIT TO CALIFORNIA

Through its successful VFA, CSAC/EDFUND has increased revenue to the Student Loan Operating Fund significantly. USED evaluates the VFA program annually and its most recent evaluation focused on four main areas: Dollar Ratio of Lender-Held Loans; Trigger Rate; Collection Recovery Rate; and Market Share. CSAC/ EDFUND compared very favorably on these measures.

Since the establishment of CSAC's VFA, EDFUND's loan servicing activities have seen significant improvements in level of service and as a result, related revenue has grown.

- Annual default rate has decreased from 3.12% in 1997-98 to 2.07% in 2002-03.
- Collection rates have increased from 15.09% in 1998-99 to 21.77% in 2002-03.
- Collection costs have been reduced by approximately 29% since 2001.

Currently, the Student Loan Operating Fund is being used to fund CSAC's administration of the Cal Grant program, which is no longer supported by the State General Fund (a \$12.96 million savings). The Operating Fund also pays for the administration of the state's Cal-SOAP (which will serve an estimated 113,982 students in 2003-04); a recently implemented outreach campaign to increase financial aid awareness and applications; and a statewide campaign to increase public awareness about Cal Grants. CSAC's ability to maintain funding for these

programs that are beneficial to California's students is at least partially dependent on the continuance of the VFA. The protection of the Student Loan Operating Fund is essential if the administration of the Cal Grant program and the outreach activities are to continue.

**The Competitive Cal Grant Program—A Report on the First Two Years:
2001-02 and 2002-03**

by the California Student Aid Commission

The report is submitted to the Legislature pursuant to Education Code Section 69437.7 on the results of the first two years of the new Competitive Cal Grant Program established by the enactment of the Ortiz-Pacheco-Poochigian-Vasconcellos Cal Grant Act (SB 1644, Chapter 403, Statutes of 2000).

- SB 1644 modified the 49-year-old Cal Grant Program into a two-tiered approach that: a) guarantees an Entitlement grant to graduating high school seniors and to specified transfer students who meet eligibility requirements; and b) annually provides 22,500 Competitive Cal Grant awards to college students who do not qualify for an Entitlement grant.
- The Commission conducts two award competitions each year. The March Competition provides 11,250 awards to students in all five postsecondary education segments. The September Competition, which also provides 11,250 awards, is reserved for students attending a California Community College.
- The report describes the application process and summarizes the quantitative results of the first two years of the Competitive Cal Grant Program.

FINDINGS

- The number of students who applied for and met all eligibility requirements for the 2002-03 Competitive Cal Grant awards exceeded 130,000 students. One in six of these qualified students received one of the 22,500 available awards. (Through the Entitlement Cal Grant Program, the number of high school graduates receiving Cal Grant awards doubled—from approximately 30,000 in 2000-01 to 60,000 in 2002-2003.)
- Overall, about 80 percent of the new Competitive Cal Grant recipients in 2001-02 activated their award and received payment. The March Competition had an 80 percent payment rate while the rate for the September Competition was 79 percent. In 2002-03, new recipients in March had a 79 percent payment rate while the September rate was 77 percent.

RECIPIENT DEMOGRAPHICS

	2001-02	2002-03
Number of Competitive Recipients	22,500	23,878*
Average income	\$15,184	\$13,610
Average GPA	3.17	3.29
Average family size	3.6	3.0
Average age	27	31

* Number funded will not exceed 22,500

Presently, the state's current commitment of 22,500 annual awards for the Competitive Cal Grant Program is insufficient to serve five out of six eligible applicants. It will take several more years of careful observation and evaluation for the Commission to have sufficient data and experience with the Competitive Cal Grant Program to identify any significant trends.