ISSUE REVIEW

Iowa Legislative Fiscal Bureau

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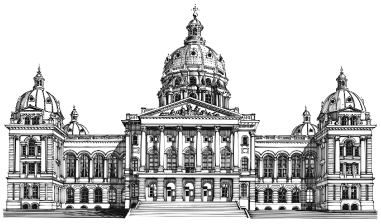

State Capitol
Des Moines, IA 50319
June 30, 1993

Guaranteed Loan Reserve Fund

ISSUE

The amount and use of the reserve for the Guaranteed Loan Reserve Fund.

AFFECTED AGENCY

The College Student Aid Commission (CSAC)

CODE AUTHORITY

Sections 261.38-261.43, Code of Iowa

Federal Register Section 682.410

BACKGROUND

In 1988, the U.S. Department of Education ruled that states operating a guaranteed loan reserve fund on behalf of the federal government could not have a reserve in excess of 2.0% of the guaranteed loans outstanding. The Iowa Guaranteed Loan Reserve Fund operated by the Iowa CSAC exceeded the permitted amount at that time. As a result, the Iowa Reserve Fund forfeited approximately $10.0 million in payments (revenue) from the federal government for business conducted by the CSAC on behalf of the federal government. The CSAC appealed the decision and lost the appeal.

There are several sources of income for the Reserve Fund, including the Federal Administrative Cost Allowance, federal payments on defaulted loans, Guaranteed Loan fees, interest income, and default collections.

CURRENT SITUATION

For FY 1993, the estimated balance of the Loan Reserve Fund is 2.24%, Iowa's balance is again in excess of the 2.0% rule established by the U.S. Department of Education.

In 1991, the CSAC received a Peat Marwick consultant report indicating the need to reduce the amount of reserve. Two alternatives suggested were:

1. To reduce the insurance premium charged to students for a loan.
2. To develop an alternative loan program.

Although both of those recommendations have been implemented, the reserve remains above the recommended amount. Therefore, the federal government may again reduce payments to the State of Iowa to reduce the reserve level.

The FY 1992 balance of the Reserve Fund was $29.6 million and on December 31, 1992 the balance had increased to $32.1 million. Section 261.38(5) of the Code of Iowa specifies that the State Treasurer invest the moneys from the Reserve Fund. During FY 1992, $2.4 million was earned in interest. House File 430 (Administration Appropriations) amended Section 261.38(5) to allow the Treasurer of State to invest up to 40.0% of the funds in the Reserve Fund in tax-exempt investments. The Governor item-vetoed this language, indicating the Treasurer already had full authority to make prudent investments of the Reserve Fund.

The purpose of the amendment in HF 430 was to decrease the amount of the Reserve Fund while permitting investment in a capital project for the State. Federal rules permit investment of the Reserve Fund in types of investments other than those related to the Federal Family Education Loan (FFEL) Programs, until the "agency subsequently sells or otherwise derives revenue from uses

of the asset that are unrelated to the FFEL Program guarantee activities, the agency deposits into the Reserve Fund a percentage of the sale proceeds or revenue equal to the percentage of the original development cost or purchase price of the asset paid with the Reserve Fund moneys." (See Attachment A)

ALTERNATIVES

The CSAC may consider the following alternatives to avoid the loss of federal funds in the future. These include recommendations from the 1991 Peat Marwick report not yet acted upon:

- Establishing collection and cure services.
- Developing a private loan guaranty program.
- Developing a private loan consolidation program.
- Developing a foundation for private industry partnerships.
- Developing a student financial assistance information center.

The consultant recommended in a letter to the director of the CSAC in February 1993, that "in light of the reauthorization of the Higher Education Act and the continued threat of Reserve Fund spend-down, it is prudent and appropriate that the Commission (CSAC) further evaluate the potential opportunity to provide additional services to Iowa citizens by exploring new affiliate organizations or increasing its participation in the alternative loan program (program developed as a result of the 1991 recommendations)."

The 1993 Peat Marwick consultant report (Attachment B) recommended the CSAC consider the following:

- Privatization of the loan guarantor operation portion of the CSAC.
- Cooperative venture and possible merger with the Iowa Student Loan Liquidity Corporation (the secondary market operation).
- Establishment of auxiliary enterprises, such as loan collection functions or a loan rehabilitation program.

- Evaluation of alliances and partnership agreements, such as with another state guarantor.

In addition, the CSAC may:

1. Further reduce the insurance premium amount charged to students receiving loans from the Program. (This was done previously in response to the 1991 Peat Marwick report.)
2. Increase the number of loans to students by expanding the newly-created alternative loan program.

BUDGET IMPACT

There is no direct impact to the General Fund.

However, loss of the federal funds eliminates the potential for investment in capital projects or other items as suggested in the study. Using reserve funds for these items could help eliminate a portion of the State's infrastructure needs and ultimately result in savings to the General Fund.

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relevant information available to the Secretary, including any information and documentation submitted by the agency. The Secretary may identify particular loans to be assigned or may require assignment of particular categories of loans that share characteristics that the Secretary determines make those loans appropriate for assignment.

(b)(1) A guaranty agency that assigns a defaulted loan to the Secretary under this section thereby releases all rights and title to that loan. The Secretary does not pay the guaranty agency any compensation for a loan assigned under this section.

(2) The guaranty agency does not share in any amounts received by the Secretary on a loan assigned under this section, regardless of the reinsurance percentage paid on the loan or the agency's previous collection costs.

(c)(1) A guaranty agency shall assign a loan to the Secretary under this section at the time, in the manner, and with the information and documentation that the Secretary requires. The agency shall submit this information and documentation in the form (e.g., computer tape) and in the format specified by the Secretary.

(2) The guaranty agency shall execute an assignment to the United States of America of all right, title, and interest in the promissory note or judgment evidencing a loan assigned under this section.

(3) If the agency does not provide the required information and documentation in the form and format required by the Secretary, the Secretary may, at his option –

(i) Allow the agency to revise the agency's submission to include the required information and documentation in the specified form and format;

(ii) In the case of an improperly formatted computer tape, reformat the tape and assess the cost of that activity against the agency;

(iii) Reorganize the material submitted and assess the cost of that activity against the agency; or

(iv) Obtain from other agency records and add to the agency's submission any information from the original submission, and assess the cost of that activity against the agency.

(4) For each loan assigned, the agency shall submit to the Secretary the following documents associated for each loan, assembled in the order listed below:

(i) The promissory note.

(ii) Any documentation of a judgment entered on the loan.

(iii) A written assignment of the loan or judgment, unless this assignment is affixed to the promissory note.

(iv) The loan application.

(v) A payment history for the loan, as described in §682.414(a)(1)(ii)(C).

(vi) A collection history for the loan, as described in §682.414(a)(1)(ii)(D).

(5) The agency may submit certified copies of required documents in lieu of originals if no originals exist.

(d)(1) If the Secretary determines that the agency has not submitted a document or record required by paragraph (c) of this section, and the Secretary decides to allow the agency an additional opportunity to submit the omitted document under paragraph (c)(3)(i) of this section, the Secretary notifies the agency and provides a reasonable period of time for the agency to submit the omitted record or document.

(2) If the omitted document is not submitted within the time specified by the Secretary, the Secretary determines whether that omission impairs the Secretary's ability to collect the loan.

(3) If the Secretary determines that the ability to collect the loan has been impaired under paragraph (d)(2) of this section, the Secretary assesses the agency the amount paid to the agency under the reinsurance agreement and accrued interest at the rate applicable to the borrower under §682.410(b)(3).

(4) The Secretary reassigns to the agency that portion of the loan determined to be unenforceable by the Department.

(Authority: 20 U.S.C. 1078, 1078-1, 1078-2, 1078-3, 1082)

§682.410 Fiscal, administrative, and enforcement requirements.

(a) Fiscal requirements. (1) Reserve fund assets. The guaranty agency shall establish and maintain a reserve fund to be used solely for the FFEL program to which the guaranty agency shall credit –

(i) Federal advances obtained and matching funds required under section 422(a) of the Act;

(ii) Funds appropriated by a State for the agency's loan guarantee program;

(iii) Federal advances obtained under section 422(c) of the Act;

(iv) Funds received by the guaranty agency as loan insurance premiums;

(v) Administrative cost allowances received by the guaranty agency under §682.407;

(vi) Funds received by the guaranty agency for the agency's loan guarantee program from gift, grant, or other sources;

(vii) Funds collected on FFEL loans;

(viii) Death, disability, bankruptcy, and reinsurance payments received from the Secretary; and

(ix) Investment earnings on the reserve fund.

(2) Uses of reserve fund assets. Except as provided in paragraphs (a)(3) - (a)(5) of this section, a guaranty agency may use the assets of the reserve fund established under paragraph (a)(1) of this section only to –

(i) Pay default claims;

(ii) Pay death, disability, and bankruptcy claims;

(iii) Refund overpayments of insurance premiums;

(iv) Pay to the Secretary the Secretary's equitable share of borrower payments;

(v) Repay advances and other funds owed to the Secretary; and

(vi) Make payments to lenders that participate in the loan referral service under section 428(e) of the Act.

(3) Special rule for use of certain reserve fund assets. (i) Except as provided in paragraph (a)(4) of this section, a guaranty agency also may use funds received as insurance premiums, administrative cost allowances, amounts collected on FFEL loans, interest or investment earnings, and receipts described in paragraph (a)(1)(vi) of this section only for payments necessary to perform functions directly related to the guaranty agency's agreement with the Secretary and for the proper administration of the guaranty agency's FFEL loan guarantee activities.

(ii) The guaranty agency shall use funds received as Federal advances under section 422(c) of the Act, and interest or other earnings on those advances, only to pay default claims.

(iii) The guaranty agency shall account separately for the funds described in paragraph (a)(3)(i) of this section.

(4) The guaranty agency may invest the assets of the reserve fund described in paragraph (a)(1) of this section only in low-risk securities, such as obligations issued or guaranteed by the United States or a State and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others.

(5) If the guaranty agency uses any funds required to be credited to the reserve fund under paragraph (a)(1) of this section to develop or purchase an asset of any kind –

(i) If the agency subsequently sells or otherwise derives revenue from uses of the asset that are unrelated to FFEL program guarantee activities, the agency promptly shall deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the sale proceeds or revenue equal to the percentage of the original development cost or purchase price of the asset paid with the reserve fund monies; and

(ii) If the agency subsequently converts the asset, in whole or in part, to a use unrelated to its FFEL loan guarantee activities, the agency promptly shall deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the fair market value or, in the case of a temporary conversion, the rental value of the portion of the asset employed for the unrelated use, equal to the percentage of the original

development cost or purchase price paid with the reserve fund monies.

(b) Administrative requirements. (1) Independent audits. The guaranty agency shall arrange for an independent financial and compliance audit of the agency's FFEL program as follows:

(i) With regard to a guaranty agency that is an agency of a State government, an audit must be conducted in accordance with 31 U.S.C. 7502 and 34 CFR Part 80, Appendix G.

(ii) With regard to a guaranty agency that is a nonprofit organization, an audit must be conducted in accordance with OMB Circular A-133, Audits of Institutions of Higher Education and Other Nonprofit Organizations and 34 CFR 74.61(h)(3). If a nonprofit guaranty agency meets the criteria in Circular A-133 to have a program specific audit, and chooses that option, the program specific audit must meet the following requirements:

(A) The audit must examine the agency's compliance with the Act, applicable regulations, and agreements entered into under this part.

(B) The audit must examine the agency's financial management of its FFEL program activities.

(C) The audit must be conducted in accordance with the standards for audits issued by the United States General Accounting Office's (GAO) Government Auditing Standards. Procedures for audits are contained in an audit guide developed by, and available from, the Office of the Inspector General of the Department.

(D) The audit must be conducted annually and must be submitted to the Secretary within six months of the end of the audit period. The first audit must cover the agency's activities for a period that includes July 23, 1992, unless the agency is currently submitting audits on a biennial basis, and the second year of its biennial cycle starts on or before July 23, 1992. Under these circumstances, the agency shall submit a biennial audit that includes July 23, 1992 and submit its next audit as an annual audit.

(2) Collection charges. Whether or not provided for in the borrower's promissory note, the guaranty agency shall charge a borrower an amount equal to reasonable costs incurred by the agency in collecting a loan on which the agency has paid a default or bankruptcy claim. These costs may include, but are not limited to, all attorneys' fees, collection agency charges, and court costs. The amount charged a borrower shall equal the lesser of –

(i) The amount that would be charged for the costs of collection under the formula in 34 CFR 30.60; or

(ii) The amount the same borrower would be charged for the cost of collection if the loan was held by the U.S. Department of Education.

(3) Interest charged by guarantee agencies. The guaranty agency shall charge the borrower interest on the amount owed by the borrower after the capitalization required under paragraph (b)(4) of this section has occurred at a rate that is the greater of –

(i) The rate established by the terms of the borrower's original promissory note;

(ii) In the case of a loan for which a judgment has been obtained, the rate provided for by State law.

(4) Capitalization of unpaid interest. The guaranty agency shall capitalize any unpaid interest due the lender from the borrower at the time the agency pays a default claim to the lender.

Effective 120 days after publication

(5) Credit bureau reports. (i) After the completion of the procedures in paragraph (b)(5)(ii) of this section, the guaranty agency shall, after it has paid a default claim, report promptly, but not less than sixty days after completion of the procedures in paragraph (b)(6)(iii) of this section, and on a regular basis, to all national credit bureaus –

(A) The total amount of loans made to the borrower and the remaining balance of those loans;

(B) The date of default;

(C) Information concerning collection of the loan, including the repayment status of the loan;

(D) Any changes or corrections in the information reported by the agency that result from information received after the initial report; and

(E) The date the loan is fully repaid by or on behalf of the borrower or discharged by reason of the borrower's death, bankruptcy, or total and permanent disability.

(ii) The guaranty agency, promptly after it pays a default claim on a loan but before it reports the default to a credit bureau or assesses collection costs against a borrower, shall provide the borrower with –

(A) Written notice that meets the requirements of paragraph (b)(5)(vi) of this section regarding the proposed actions;

(B) An opportunity to inspect and copy agency records pertaining to the loan obligation;

(C) An opportunity for an administrative review of the legal enforceability or past-due status of the loan obligation; and

(D) An opportunity to enter into a repayment agreement on terms satisfactory to the agency.

(iii) The procedures set forth in 34

escrow agent.

Section 682.408(a)

Comment: Some commenters felt that this provision should be expanded to allow for the disbursement of PLUS loans through an escrow agent.

Discussion: The Secretary agrees with the commenters as the statute does not restrict the use of an escrow agent to Stafford and SLS loans.

Changes: The regulations have been amended to allow PLUS loan proceeds to be disbursed through an escrow agent.

Comment: Some commenters stated that the prohibition against an escrow agent being a school or State lender should be removed.

Discussion: Section 428(i)(1) of the Act prohibits "an eligible institution or an agency or instrumentality of the State" from acting as an escrow agent.

Changes: None.

Section 682.410 - Fiscal, Administrative, and Enforcement requirements.

Section 682.410(a)

Comment: One commenter requested that the Secretary specify the permissible uses of the reserve fund, e.g., whether a guaranty agency may use its reserve fund to establish a servicer for pre-default loans.

Discussion: A guaranty agency may use the assets of its reserve fund only as permitted by §682.410(a). Paragraph (a)(3) of that section permits a guaranty agency to use a specific portion of its reserve funds "... only for payments necessary to perform functions directly related to the guaranty agency's agreement with the Secretary and for proper administration of the guaranty agency's FFEL loan guarantee activities." The costs of operating a loan servicer for loans that have not yet defaulted clearly are unrelated to the expenses incurred by a guaranty agency in providing loan guarantees to lenders and are, therefore, not permissible. This policy applied to all agencies as of December 26, 1986, the date the final regulations published by the Department on November 10, 1986 went into effect. The Secretary believes that the use of any reserve funds for for-profit enterprises is not permitted because of the risk to funds dedicated to the FFEL program.

Changes: None.

Section 682.410(a)(3)

Comment: Several commenters objected to the proposed restrictions on the use of borrower payments by guaranty agencies contained in §682.410(a)(3)(iv). The commenters believed that these restrictions conflict with section 428(c)(6) of the Act, which allows guaranty agencies to use the percentage it retains of borrower payments "for costs related to the student loan insurance program, including the administrative costs of collection...."

Discussion: The Secretary agrees with the commenters that the proposed restrictions represent a narrow interpretation of the intent of the statute and that agencies should be allowed to use borrower payments for activities supporting the proper administration of the guaranty agency's loan guarantee activities.

Changes: Section 682.410(a)(3)(iv) has been deleted and "amounts collected on FFEL loans" has been added to the other items specified in §682.410(a)(3)(i) that can be used to support the agency's administration of its loan guarantee activities.

Section 682.410(b)(2)

Comment: Many commenters objected to the requirement that a guaranty agency must assess collection charges against the borrower. Other commenters stated that if collection charges had to be assessed, a flat rate should be used by each guaranty agency.

Discussion: The statute clearly specifies that, notwithstanding any provision of State law to the contrary, collection charges must be assessed against the borrower. See section 484A(b) of the Act. The formula referenced in §682.410(b)(2) specifies that the amount charged will be the lesser of the costs of collection under the formula in 34 CFR 30.60, or the amount the borrower would be charged if the loan was held by the Department. This amount will be a percentage of the principal and interest outstanding, may be calculated annually, and would be a flat rate assessed against all borrowers with defaulted loans held by that agency.

Changes: None.

Section 682.410(b)(4)

Comment: Some commenters questioned what charges a guaranty agency may capitalize after a default claim has been paid.

Discussion: A guaranty agency is required to capitalize any interest owed on the loan by the borrower. This may include interest that was not paid to the lender by the guaranty agency and interest paid by the guaranty agency that will not be reimbursed by the Secretary.

Changes: This provision of the regulations has been amended to clarify that all interest, rather than "unpaid charges" owed by the borrower, must be capitalized by the guaranty agency.

Section 682.410(b)(5)

Comment: Many commenters vigorously opposed the provision that requires a guaranty agency to grant a borrower an opportunity for an administrative review of the legal enforceability or past-due status of the loan obligation before reporting the default to a credit bureau or assessing collection costs against the borrower. The commenters stated that a defaulted borrower had already had ample opportunity throughout the repayment period to protest the debt and that the administrative review would result in a substantial administrative burden for an agency and would delay any recovery of the debt. In addition, the commenters felt that section 430A of the Act set the parameters of credit bureau reporting for the FFEL programs and that an opportunity for an administrative review was inconsistent with congressional intent.

Discussion: Federal law requires notice and opportunity to contest a debt before a default is reported to a credit bureau. See 31 U.S.C 3711(f). Moreover, in light of the serious consequences of credit bureau reporting for a borrower, the Secretary believes it reasonable and appropriate for a borrower to have an opportunity to contest the default. The Secretary believes that a guaranty agency should not have difficulty implementing this requirement as it already provides an opportunity for review when it assigns a loan to the Secretary for participation in the Internal Revenue Service (IRS) offset process. The statute authorizing Federal agencies to collect debts by administrative offset also requires the agency to provide a debtor with notice of a proposed IRS offset and at least 60 days in which to present evidence regarding the debt. See 31 U.S.C. 3720A. In the FFEL program, the Secretary provides this opportunity to a debtor by a review and an initial determination by the guaranty agency that held the debtor's loan and maintains

ATTACHMENT B

KPMG Peat Marwick

Management Consultants

Quality and experience
for measurable results

Manufacturing and Technology Industries

Financial Institutions

Insurance

Real Estate and Hospitality

Health Care

Government Services

Higher Education and Not for Profit

Airports

Retail and Wholesale

Energy

Utilities

Environmental

Iowa College Student Aid Commission

RECOMMENDATIONS FOR ORGANIZATIONAL CHANGE AND INITIATIVES

Final Report
May 1993

EXECUTIVE SUMMARY

For organizations participating in the Federal Family Education Loan (FFEL) Programs, the industry environment is characterized by political uncertainty, increased competition, unpredictable growth dynamics, and greater exposure to Department of Education liability assessments.

Despite the industry turmoil, the Iowa College Student Aid Commission (ICSAC, or the Commission) continues to meet the needs of its constituent groups which include student and parent borrowers, schools, and lenders. ICSAC's success in promoting the FFEL Programs and supporting lenders can be partially measured in its guaranty activity increase of 55% in the last two years. However, due to the state's objective to contain state employment levels, ICSAC has not hired any additional employees to manage the new volume. Based upon the recent growth in guaranty volume and significant projected increases, if ICSAC does not hire additional staff soon, personnel shortfalls will impede the Commission's ability to manage its programs and to provide outstanding service to its constituency.

The rapid growth, the dynamics of a changing industry, and the need to comply with ever changing government regulations require an organizational structure that is flexible and dynamic. Under the current state control structure ICSAC does not have this flexibility and dynamic nature.

Based upon the current industry environment and ICSAC's individual circumstances, KPMG Peat Marwick recommends the following:

1. ICSAC should consider major organizational change by privatizing its loan guarantor operations consistent with Department of Management guidelines.

2. In conjunction with privatization, ICSAC should evaluate its relationship with the Iowa Student Loan Liquidity Corporation. Such an evaluation might entail exploring additional cooperative ventures and ultimately, the benefits and feasibility of merging the two organizations.

3. The potential establishment of auxiliary enterprises should be identified and evaluated as a means of fully utilizing the Commission's resources and strengthening the Commission's fiscal base.

4. Potential strategic alliances and/or partnership agreements should be identified and evaluated as a means of fully utilizing the Commission's resources.

1986 HEA on December 18, 1992. These regulations require guarantors to act quickly to comply with or enforce new regulations, despite the need for clarification or lack of guidance in some cases.

The need to comply with the December 1992 regulations, coupled with the phased-in implementation of new requirements resulting from the HEA legislation has created an overload of compliance and policy issues for guarantors.

Clinton Proposal

In February 1993 President Clinton unveiled his fiscal plan entitled "A Vision for Change in America." Among the provisions of the plan is a proposal to eliminate the FFEL Programs by 1997 and replace it with a Federal Direct Loan Program. Under direct lending, the federal government would be the lender as opposed to the private sector. Since the federal government would own the loan, the necessity and role of state guarantors is uncertain.

Under the Clinton proposal, schools would be converted from FFEL participants to direct lending participants over a four-year period. The schedule calls for 500 schools to be converted in 1994, 500 schools in 1995, 1,500 schools in 1996, and the remainder in 1997.

. . . . .

In conclusion, in the next four years, based upon the recently enacted Higher Education Amendments of 1992, ICSAC can anticipate 25% annual loan guarantee volume increases over the next four years. Even if a full implementation of direct lending occurs, ICSAC would still experience significant growth through 1996, but decreasing volume in 1997 and in 1998 when guaranty activity would cease. And, given the average loan amortization period in Iowa of at least ten years, under a wind-down scenario ICSAC must be still be prepared to conduct its loan operations through the year 2008. There is also considerable speculation that even with a transition to direct lending, there would be new, significant roles in the student aid delivery process for current guarantors.

INDUSTRY TRENDS

The major industry trends with respect to guarantors can be identified as follows:

1. Competition among guarantors for market share is increasing.

and the Clinton proposals has left program participants with no clear idea where the FFEL Programs are headed. The dynamic change confronting guarantors requires them to be organizationally flexible to respond quickly to new initiatives, competition, or regulations. The challenge for guarantors, and the turmoil in the industry is illustrated in the comments from the annual reports of several guarantors:

Texas Guaranteed Student Loan Corporation:

> "To anyone looking in from the outside, and to many working within the industry, the year seemed to be one of great complication - and some confusion - as new ideas challenged the most basic precepts of the education loan programs."

Nebraska Student Loan Program:

> "We live with the constant change that characterizes our industry by being flexible and able to react quickly."

New York State Higher Education Services Corporation:

> "The Board takes great pride in the manner in which NYSHESC has faced the difficult challenges of the past few years, including significant reductions in State funds, while continuing to reach out to constituents and develop new, innovative ways in which to simplify and improve processing of financial aid in New York State."

United Student Aid Funds, Inc. (USAF):

> "...as times change and the demands on participants in the Federal Family Education Loan Program increase, USA Funds has found it necessary to restructure so we can efficiently and effectively meet the financial needs of students well into the future."

Department of Education Micro-enforcement of Regulations

The last five years has seen a disturbing trend in Department of Education micro-enforcement of program regulations. The potential liability exposure for FFEL Program participants is enormous. Multi-million dollar liability assessments by the Department for relatively minor violations are now commonplace. Lenders and guarantors cannot be too careful in performing due diligence. Parties wishing to dispute the liability will find the costs to settle the issue can be significant.

PERFORMANCE OF THE IOWA COLLEGE STUDENT AID COMMISSION

Despite the turmoil in the industry, the Iowa College Student Aid Commission continues to meet the needs of Iowans: In FY 1992, ICSAC:

- Processed $269 million in aid to 73,000 students
  - $39 million in state scholarships, grants, and work-study programs
  - $230 million in student loans

- Introduced the Iowa Partnership Loan Program in conjunction with the Iowa Student Loan Liquidity Corporation (ISLLC).

- Reduced the guarantee fee to 50 basis points while maintaining a fiscally sound program.

- Maintained a default rate of 7.74%, which is less than half the nation's average. This will save the state money, as President Clinton is proposing that states share half the default costs when the state default rate exceeds 20%.

- Ensured fiscal integrity of the program by maintaining a healthy fund balance.

In meeting the increased need for student aid in Iowa, the size of the ICSAC's FFEL Guaranty Program has increased significantly:

- Loan guarantees increased from $198.5 million in FY 1991 to $258.7 million in FY 1992, an increase of 30%.

- The cumulative outstanding balances on guarantees increased from $1.02 billion in FY 90 to $1.29 billion in FY 92, an increase of 26.4%.

- Collections on defaulted loans increased from $7.63 million in FY 91 to $8.95 million in FY 92, an increase of 17.3%.

Ramifications of the State's Employment Containment Objectives on ICSAC's Performance

Given the recent and projected increases in the size of the Commission's loan guaranty portfolio, the state's commitment to contain state employment levels will soon impact the Commission's ability to provide service to Iowans, will impose operational limitations that could result in program liability, and will hinder flexibility in responding to the changes in the industry.

4. Potential strategic alliances and/or partnership agreements should be identified and evaluated as a means of fully utilizing the Commission's resources.

Privatization of ICSAC

In December 1992 the Iowa Department of Management issued a report, *A GUIDE TO PRIVATIZATION IN IOWA*. This report identified privatization as an alternative method of delivering services. It suggests that traditional government services might best be delivered by non-state entities. The report stated that under the right circumstances privatization could result in higher quality services being provided at lower cost. As a result of these findings it suggests that "It can no longer be assumed that only government is capable of performing a function," and that, "With this in mind, the exploration of privatization as a process is in order."

Based upon the changing demands of the industry and the need for organizational flexibility, KPMG Peat Marwick believes that the "privatization" of the ICSAC guarantor functions could provide the organizational structure and flexibility that would improve ICSAC's ability to deliver service and products to Iowans.

The dynamics of the industry are changing daily. In order to continue to provide superior service to Iowans, ICSAC must become an organization that can react quickly and decisively in meeting new program changes and requirements.

Therefore, our initial recommendation is that ICSAC should consider privatization of its guarantor operations. The benefits of privatizing ICSAC would be as follows:

1. Privatization would permit ICSAC to rightsize its guarantor operations based upon growth or decreases in its guaranty volume. The state would not have to finance and incur the long-term obligations of additional staff if the program expands. ICSAC would have the organizational flexibility to react to potential but unforeseeable change such as a 30% growth or 25% decline in guarantee activity.

2. ICSAC would be able to better manage certain functions that cannot be outsourced, such as claims processing.

3. Privatization would permit ICSAC to more fully utilize its resources in providing services to Iowans, and utilizing its financial resources to enhance the fiscal strength of the Commission.

4. ICSAC would be able to reduce expenditures by performing certain services in-house.

The Privatization Process

A privatization of ICSAC should follow the guidelines of the Department of Management. As discussed in *A GUIDE TO PRIVATIZATION IN IOWA*, a structured process should be undertaken in evaluating and initiating a privatization effort.

1. Validate the concept that the mission and operations of ICSAC are conducive to privatization.

2. A cost-benefit analysis should be performed.

3. A schedule to identify activities and time frames should be developed.

4. An analysis of the legal issues in moving ICSAC from the government to the private sector must be undertaken. In particular, how would such an arrangement comply with state procurement requirements.

Privatization Precedent

In 1987, the Student Loan Guarantee Foundation of Arkansas (SLGFA) separated from the state government of Arkansas, and established as a private, non-profit corporation under Internal Revenue Code section 501(c)(3).

The restructuring permitted the SLGFA to better meet the needs or Arkansans by permitting personnel growth and the creation of new school and lender support services.

Evaluate Relationship with the Iowa Student Loan Liquidity Corporation

In 1991/92 ICSAC formed a successful partnership with the Iowa Student Loan Liquidity Corporation in establishing the Iowa Partnership Loan Program.

The uncertain industry environment will create new opportunities for guarantors and secondary markets to cooperate or to compete. Given an environment where growth potential and organizational survival is in issue, cooperation could permit both organizations to survive and perhaps prosper for a longer period of time. However, if the two organizations compete, this competition could be wasteful and hurt both organizations.

Peat Marwick recommends that talks be initiated with the Iowa Student Loan Liquidity Corporation for the purpose of establishing a dialogue on potential cooperative ventures. Potential cooperative ventures could include areas where both organizations have potential

agreement with the Secretary to establish a loan rehabilitation program for all borrowers for whom the Secretary has paid a reinsurance claim.

In establishing a loan rehabilitation program there is an opportunity for ICSAC to assist Iowa borrowers, generate revenue by purchasing and servicing rehabilitated loans, and create a shelter for agency reserves. A loan rehabilitation program would permit ICSAC to assist borrowers who have experienced difficulty in repaying their loans. In addition, ICSAC could realize a favorable yield on these loans. Finally, the loans would be classified as a receivable and subsequently not counted as part of the reserve fund.

Strategic Alliances/Partnership Agreements with Other Guarantors

There may be benefits to seeking out a strategic alliance or partnership agreement with another state guarantor. Other states have benefitted from such alliances. For instance, in 1992 the Pennsylvania Higher Education Assistance Agency formed a new venture with financial-aid agencies in Colorado, Utah, and Montana to design and build an advanced loan-guaranty computer system. This new guaranty system is to be operational in spring 1994. There may still be an opportunity for ICSAC to secure the use of this system, although the marketing ramifications of leaving USAF would be considerable. If ICSAC obtains the use of a guaranty agency system, it should evaluate whether to offer servicing to another state.

An opportunity also exists for Iowa to benefit from its traditionally low default rate. As previously stated, many guarantors are seeking to expand into other states in order to create increased volume and to reduce their percentage of high risk loans. ICSAC could consider merging with another state guarantor with a higher default rate. Such a merger could create benefits for the combined organizations.

It goes without saying that a potential merger or a strategic alliance entails significant risk. These ventures should only be considered after performing the highest due diligence.

CONCLUSION

The current uncertainty of the Federal Family Education Loan Programs present a major challenge for ICSAC and all organizations involved in the Programs. ICSAC must be prepared to meet these challenges by evolving into an organization that is capable of rapid change, both in terms of meeting constituent needs, and in terms of managing its operations.

ICSAC is not currently an organization capable of rapid change. KPMG Peat Marwick

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