CSLF CONNECTICUT STUDENT LOAN FOUNDATION

MINUTES OF THE BOARD OF DIRECTORS

October 23, 2013

A meeting of the Connecticut Student Loan Foundation's Board of Directors was held on Wednesday, October 23, 2013 at 3:00 p.m., at the office of the Connecticut Board of Regents for Higher Education, 39 Woodland Street, Hartford, Connecticut 06105.

Board Members Present in Person:

Sarah K. Sanders (designee of the State Treasurer of Connecticut) – Chairman of the Board
James R. Howarth (designee of the President of the Connecticut Board of Regents for Higher Education) – Vice-Chairman of the Board
Craig S. Lappen (designee of the Chairman of the Connecticut Board of Regents for Higher Education) – Secretary of the Board

Other Attendees:

Christine Shaw, Esquire – Connecticut Office of the Treasurer
Yvette Melendez – Connecticut Board of Regents for Higher Education
Elizabeth Caswell – Connecticut Board of Regents for Higher Education
Ben Barnes – Connecticut Office of Policy & Management
Michael Sullivan – Connecticut Office of Policy & Management
Kerry Kelley – Connecticut Office of Policy and Management
Steve Kitowicz – Connecticut Office of Policy and Management
Jane Ciarleglio – Connecticut Office of Higher Education
Mark French – Connecticut Office of Higher Education
Barbara Rubin – Connecticut Health and Educational Facilities Authority
Jeff Asher – Connecticut Health and Educational Facilities Authority
Paula Herman, Esquire – Connecticut Health and Educational Facilities Authority
Jeanette Weldon – Connecticut Higher Education Supplemental Loan Authority
Sam Rush – Connecticut Higher Education Supplemental Loan Authority
Nancy A. D. Hancock, Esquire – Pullman & Comley, LLC
Darlene H. Dimitrijevs – Education Solution Partners, LLC
Randall M. Behm – Education Solution Partners, LLC

I. Call to Order:

Ms. Sanders called the meeting to order at 3:00 p.m. Ms. Sanders, Mr. Howarth, Mr. Lappen, Ms. Hancock, Ms. Dimitrijevs and Mr. Behm were present.

II. Approval of July 24, 2013 Minutes:

A motion was made by Mr. Lappen and seconded by Mr. Howarth that the Board of Directors of the Connecticut Student Loan Foundation approves the minutes of July 24, 2013 as corrected.

The motion passed unanimously.

III. Financial Report:

Ms. Dimitrijevs provided the financial report as of September 30, 2013. She presented the Balance Sheet, Net Change in Assets, Non-Trust Cash Flow, Bond Redemptions and Funds Management Ratios.

Ms. Dimitrijevs noted that the financial statements include the early adoption of GASB 65, which requires that all closing costs for bond issuances be written off in the year incurred rather than amortized over the life of the bonds. This resulted in the reversal of the expense amortization that had been reported in earlier financial reports for the fiscal year and the removal of the remaining deferred closing costs ($776,000) with an offset directly to net assets. GASB 65 did not affect the deferred Bond Discount or its amortization.

In addition, the presented financial reports include a loan loss provision of $700,000 for federal loan risk sharing. This addition to the loan loss allowance was discussed and approved later in the meeting.

She indicated that the trust parity ratio now stands at 107.26% versus a planned level of 105.14%. Assets within the Trust exceed the Board required parity level by $14.7 million. Ms. Dimitrijevs noted that the Due from ECMC of $4.5 million as of the end of September has already been received in October. She also pointed out that as of the end of the fiscal year the face value of bonds outstanding had fallen below the amount of loans that served as collateral for the first time since the bonds were issued.

Mr. Barnes joined the meeting at this point (3:05 p.m.).

Ms. Dimitrijevs continued, stating that the Net Change in Assets is $6.5 million through the fiscal year end, compared to a budget of $2.2 million. The primary positive variances were:

- Increased net interest spread resulting from the faster redemption of bonds versus pay down of loans and the upgrade of the subordinate bonds ($2.1 million)
- Higher collection retention received from ECMC ($1.7 million)
- No expenditures on Public Purpose projects ($1.2 million)
- Not-for-Profit Servicing income ($0.6 million)

The positive variances were offset by:

- Bad debt expense to increase the Loan Loss reserves ($1.5 million)
- Bond discount amortization associated with faster bond redemptions ($0.4 million)

The Non-Trust Cash Flow of CSLF continued to be positive for the quarter at $179,352. For the fiscal year, the Non-Trust Cash Flow was $1.0 million.

Ms. Dimitrijevs reviewed the bond redemption activity for both the quarter and the full fiscal year. $19.0 million in bonds were redeemed in the quarter and $109.35 million in bonds were redeemed for the entire fiscal year. Five tranches of bonds were retired during the fiscal year. As of September 30, 2013, $415.65 million in bonds remain outstanding. The original issuance was $935.9 million.

Ms. Dimitrijevs reviewed the funds management levels within the trust estate and indicated that CSLF is in compliance with its internal policies, as well as the requirements of the trust indenture, for all three ratios.

Finally, Ms. Dimitrijevs referred to a recent letter from the U.S. Department of Education (DOE) with respect to the Not-for-Profit Servicer Program. In that letter, the U.S. DOE indicated that they would be reviewing all NFP Servicers for future allocations in August, 2014. They intend to use the measurement criteria outlined in the statutes which created this program. They will award additional loans based upon the relative rankings of the servicers. Additional allocations would provide additional revenue for CSLF. However, the U.S. Department of Education indicated that if a servicer did not meet the minimum standards for the criteria, then that servicer's existing accounts would be transferred to another servicer. At this time, the DOE has not published the minimum standards This means there is a risk that CSLF could lose its allocation, depending upon the performance of its sub-servicer (EdFinancial Services). Mr. Behm noted that we know the metrics that are being tracked, from the legislation, but do not have the minimum standards for those metrics. He also indicated that CSLF's ratings are better than some of the NFP Servicers in some criteria and worse in others.

IV. <u>Loan Loss Reserve Analysis:</u>

Mr. Behm provided a review of the current loan loss allowance versus the actual performance of the loan portfolios. He indicated that the Federal Loan portfolio has not been declining as quickly as had been anticipated. As a result, even though delinquency and claims filings have declined as a percentage of the portfolio, the overall dollar amount has not declined as rapidly as anticipated. He also noted that this is the primary reason for the income CSLF has received from ECMC is above plan. Assuming that the current delinquency rate of 15.7% will aaply to the entire portfolio, including the loans that have not yet entered repayment, and that all the delinquent loans will default, CSLF's risk share would result in $1.3 million of losses in the future on the Federal Loans. An addition of $500,000 to the Federal Loan Loss Allowance would be required to cover the future losses. In order to further protect against future losses, a $700,000 addition to the Federal Loan Loss Allowance was requested.

Mr. Behm then reviewed the performance of the Alternative Loan portfolio with regard to its Loan Loss Allowance. He noted that the net cumulative default rate on this portfolio, as of September 30, 2013, was 23.5%. Projections call for net losses of $444,000 during the 2013-14 fiscal year. Assuming that the loans that are not yet in repayment ($1.2 million) default at the same level as those that have already entered repayment, they would produce $293,000 in losses, for a total of $737,000 in future losses. This is slightly below the current Alternative Loan Loss Allowance of $796,154. Mr. Behm also noted that in the quarter ended June 30, 2013, the Alternative Loan portfolio experienced net recoveries for the first time ever. Mr. Behm concluded that the Alternative Loan Loss Allowance appears to be adequate, and no request was made for additional Alternative Loan Loss provision.

A motion was made by Mr. Lappen and seconded by Mr. Howarth as follows:

WHEREAS, the Board of the Connecticut Student Loan Foundation has reviewed the performance of its Federal and Alternative loan portfolios and believes it is prudent to provide for future losses on such loans;

NOW THEREFORE, BE IT:

RESOLVED, that the Federal Loan Loss Reserve shall be increased by $700,000 retroactive to September 30, 2013.

The motion passed unanimously.

Ms. Shaw, Ms. Caswell, Mr. Sullivan, Ms. Kelley, Mr. Kitowicz, Ms. Ciarleglio, Mr. French, Ms. Rubin, Mr. Asher, Ms. Herman, Ms. Weldon and Mr. Rush joined the meeting at this point (3:15 p.m.).

V. <u>External Reviews:</u>

Ms. Dimitrijevs indicated that two external reviews of CSLF were concluded during the quarter. The Connecticut Auditors of Public Accounts completed their review for the fiscal year ended September 30, 2012. The report had one finding – that the Board is operating with only its three ex-officio members leaving eleven vacancies. This was a repeat finding from the previous audit. Ms. Sanders noted that the Board responded by acknowledging this finding and is currently reviewing strategic options for the future of CSLF and plans to complete this review before seeking legislation to modify the board composition or to actively seek the appointment of additional board members. Ms. Sanders further noted that this was the reason for requesting various individuals to attend this CSLF Board meeting and participate in the discussion under a later agenda item.

Ms. Dimitrijevs then discussed the Common Review Initiative report from the U.S. Department of Education. Common Reviews are conducted at various times by designees of the U.S. Department of Education to exam portions of the federal loan program. This particular review was to determine compliance by Sallie Mae in servicing loans for other entities. While CSLF no longer owns any loans serviced by Sallie Mae, the time period that was covered by the review included a period of time that CSLF did have loans serviced by Sallie Mae. The review covered 138 lenders serviced by Sallie Mae. The report contained some exceptions; however, the report noted that no exceptions occurred in the CSLF portfolio.

VI. <u>2014 Schedule of Meetings:</u>

Mr. Howarth made the following motion, which was seconded by Mr. Lappen, that the Board of Directors of the Connecticut Student Loan Foundation approves the 2014 Meeting Schedule as follows:

- January 22, 2014 2:00 p.m.
- April 23, 2014 2:00 p.m.
- July 23, 2014 2:00 p.m.
- October 22, 2014 2:00 p.m.

The motion passed unanimously.

Ms. Melendez joined the meeting at this point (3:25 p.m.).

VII. <u>CSLF Organization and Board Makeup:</u>

Ms. Sanders opened this section of the meeting by asking everyone in attendance to introduce themselves and their current role within the State of Connecticut or with CSLF. She then asked Mr. Behm to provide an overview of the Connecticut Student Loan Foundation using a presentation that had been made to the Board of the Connecticut Higher Education Supplemental Loan Authority (CHESLA) on September 17, 2013.

Mr. Behm provided a summary of the history of CSLF. He noted that CSLF was created by the Connecticut legislature in 1965 as a public purpose 501(c)(3) non-profit entity. As such, it is not a Connecticut state agency, but is subject to certain State oversight (e.g., the Board consists of state ex-officio members and state appointees, the Auditors of Public Accounts audit the organization, and an annual report is provided to the Governor and the Legislature). The public purpose of CSLF, as defined in the legislation, is: “to improve educational opportunity and promote repayment of loans”.

Mr. Behm noted that federal legislation that was negotiated in 2009 as part of the Health Care Reform legislation and became effective July 1, 2010, significantly altered the activities of CSLF. This legislation moved all lending and guarantee functions to the U.S. Department of Education for any new federal education loans made after July 1, 2010. As a result, the three major business activities of CSLF--guaranteeing loans, making loans and issuing municipal bonds to finance the loans--would all be discontinued. CSLF’s existing portfolios remained, but there would be no new business activity in these areas.

At the same time, CSLF was experiencing other difficulties. CSLF had three consecutive years of nearly $1 million operating losses in each year, a severely underfunded pension plan, a building that was in foreclosure proceedings, an unfavorable audit report from the Auditors of Public Accounts and resignations from all of the Board members, except the ex-officio members. As a result the Board took action in 2009 to reduce staff, eliminate non-essential expenses and, with the consent of the U.S. Department of Education, transfer the guarantee functions to Educational Credit Management Corporation (ECMC). In 2010 the Board took further action to eliminate all remaining staff, vacate the facility in Rocky Hill (as required by a court order) and outsource any remaining functions to Education Solution Partners based upon an RFP process.

The agreement with ECMC was discussed at some length. Mr. Behm indicated that the agreement provided for a revenue sharing arrangement through December 31, 2014. This revenue sharing has resulted in significant funds to CSLF. Ms. Dimitrijevs noted that when the agreement was first put in place, it was not expected to generate substantial income because of a $4.6 million liability CSLF was carrying as owed (but contesting) to the U.S. Department of Education resulting from an audit (often referred to as the “Ollie Green” audit). Under the ECMC agreement, CSLF would receive no revenue sharing until that liability to the U.S. Department of Education, along with other liabilities of CSLF, which were paid by ECMC, had been recovered by ECMC through revenue from the agreement. However, in 2010, the U.S. Department of Education forgave all of the “Ollie Green” liabilities that were owed by all federal guarantee agencies. As a result, CSLF promptly started receiving funds under the ECMC agreement.

Mr. Behm indicated that beginning with the fiscal year ended September 30, 2010, CSLF has experienced annual, multi-million dollar positive earnings. For the most recent fiscal year ended September 30, 2013, the unaudited financial results show a positive change in net assets of $6.5 million. He also noted that since 2009, the outstanding bonds have been reduced from nearly $900 million to $435 million and that the subordinate bonds have been upgraded to "AA", while the senior tranches have remained rated "AAA". The defined benefit pension plan was fully funded and terminated with a closing letter from the IRS, with former employees receiving annuity contracts.

Mr. Behm then provided an overview of the major fund categories that compose the Net Assets of CSLF as of June 30, 2013:

<u>Unrestricted:</u> $5.7 million

Subject to the public purpose of CSLF, these funds are available for the operating expenses of CSLF and any purpose designated by the Board.

<u>Restricted:</u> $12.7 million

These funds are the result of the agreement with ECMC and approved by the U.S. Department of Education. That agreement restricts these funds to only public purposes (not operating expenses), that are similar to CSLF's legislated public purpose. These funds are further restricted to higher education purposes.

<u>Trust Restricted:</u> $31.4 million

These funds are subject to the Trust Indenture governing the Municipal Bonds issued by CSLF. However, as noted above, the Board-required parity level in the Trust is currently exceeded by $14.7 million. The $14.7 million could be released, by Board action, to the Unrestricted Fund as cash is available in the Trust. It is estimate that it would require about a three month period for the Trust to generate this cash without further bond redemptions.

Mr. Behm also noted the last page of the presentation contained a comparison of CHESLA to CSLF.

Ms. Sanders provided a document containing three possible scenarios for CSLF going forward and her estimate of the pros and cons of each scenario and the actions required to implement them.

Option 1 was to continue to run CSLF as it currently is structured. Under this option, she noted that CSLF has experienced external professionals supporting the Board in the day-to-day management of CSLF's affairs, however the current structure poses some risks. Ms. Sanders also indicated that Option 1 provides more total funds for public purpose, both in present value as well as total over time, than a sale of the loans and the dissolution of CSLF. On the negative side, this option requires time and attention by several state officials and appointees to run the entity which is in a wind down status and is no longer performing its intended purpose. Continuing to run CSLF as it is currently structured will require appointments to fill the Board, or legislation to change the Board composition, as noted in the report from the Auditors of Public Accounts.

Option 2 was to dissolve CSLF and use the remaining funds for CSLF's public purpose. This scenario would create an immediately available pool of funds of approximately $50 million. It would also eliminate the need to continue to direct the time and attention of state officials to this entity for at least another 10 years. Ms. Sanders noted, however, that dissolution produces smaller cash flow and has a present value of approximately $7 to $10 million lower than continuing to run CSLF. Under the legislation that created CSLF, in the event of its dissolution any remaining funds are to be given to the scholarship funds of the Non-Profit Institutions of Higher Education located in Connecticut. The Board of CSLF is required to designate the amount of funds that each school's scholarship fund is to receive. Dissolution of CSLF may also require legislative action to complete.

Option 3 was to continue to run CSLF, but as an affiliate of CHESLA. Under this scenario, Ms. Sanders noted that CHESLA and its parent, the Connecticut Health and Educational Facilities Authority (CHEFA) are fully staffed and have full boards in place. Combining with an active student loan agency can provide synergies; including using available CSLF funds to support new or ongoing programs. She also noted that this option provides more total funds for public purpose than Option 2 (dissolution). However, Ms. Sanders noted that federal education loans have special requirements that will likely require support from some outside professionals. In addition, the continued operation of CSLF, even as an affiliate of CHESLA, will require time and attention by state officials and their designees. Legislative action will be required to make CSLF a part of CHEFA or CHESLA. In addition, the board structure of CSLF would need to be altered to comply with the board requirement structures for subsidiaries of CHEFA. On this last point the representatives from CHEFA noted that the CHEFA board members were already on multiple boards.

In response to a question concerning what possible uses CSLF has considered for the use of the funds, Ms. Sanders indicated that CSLF has considered scholarship programs and had also issued an RFI for Debt Management programs at the end of 2012. Ms. Dimitrijevs provided a brief overview of the results of the Debt Management RFI. Ms. Sanders noted that no action had been taken on the responses to the RFI as the overall direction of CSLF was unclear. She also indicated that CSLF had looked at using funds to assist the Community Colleges in Connecticut.

Ms. Weldon was asked by Ms. Sanders to provide a description of some of the new initiatives that CHESLA is considering. Ms. Weldon indicated that there are four of them.

The first is a program to encourage STEM (Science, Technology, Engineering and Mathematics) training by offering loans with a 0% interest rate durng any period of time the borrower is working in a STEM field within the State of Connecticut. She noted, however, that CHESLA did not have the financial resources for this program and would require an equity contribution to fund it.

The second program is a cosigner release on loans after 5 years if all payments are made on time and the borrower meets the credit criteria at that time. Ms. Weldon noted that CHESLA's main competition for loans was the Federal PLUS loan program offered by the U.S. Department of Education (a program that makes unlimited loans to parents with minimal credit standards). One way to compete with the federal loan is to offer parents a way to make the loan solely the responsibility of the student borrower.

A third program would be to allow students to defer payment on their CHESLA loans while the student attends Graduate School. This would allow the CHESLA loan to match the PLUS loan, which already allows for deferment of payments while the student is attending any accredited school at least half-time.

A fourth program is considering lowering the credit standards of the current CHESLA loan to allow for more approvals. Ms. Sanders noted that only 50% of the CHESLA loan applicants are currently approved. Ms. Weldon indicated that this lowering of the credit criteria would again make the CHESLA loan more competitive with the PLUS loan, but that CHESLA would likely not go as far down the credit spectrum as the PLUS loan. She also noted that the reduced credit criteria would likely result in increased loan losses and it was unclear if CHESLA could afford those losses without an equity infusion.

At this point Ms. Sanders opened the floor for a more general discussion of the options for CSLF. There ensued a wide-ranging discussion about CSLF. Considerable discussion was generated around the currently available funds for public purpose as well as the projection for future funds if CSLF continues. In addition to discussing the amount of funds, some potential uses for the funds were discussed.

In response to a question about CHESLA's interest in managing CSLF, it was indicated that CHESLA and CHEFA have not had any in-depth discussions about CSLF. However, Ms. Rubin indicated there is an interest in some combination of CSLF with CHEFA and CHESLA, subject to due diligence, and to do whatever is in the best interests of the State of Connecticut.

Another area of discussion was the make-up of the CSLF Board. It was suggested that CSLF may want to request that the various appointments be filled. This would allow for more decision makers to be present in the discussions about the future of CSLF.

VIII. <u>Adjournment</u>

Ms. Sanders then asked whether there was any other business properly brought before the Board, and there was none. Ms. Sanders requested a motion for adjournment.

Mr. Howarth made a motion, which was seconded by Mr. Lappen to adjourn the meeting.

The motion passed unanimously and the meeting was adjourned at 4:40 p.m.

Respectfully Submitted for the
Board of Directors by:

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Craig S. Lappen, Secretary