

The logo for the Texas Sunset Advisory Commission features the text "Texas Sunset Advisory Commission" in a bold, serif font, centered within a black semi-circular shape. This shape is enclosed by a white border and sits atop a thick black horizontal bar.

**Texas
Sunset
Advisory
Commission**

STAFF EVALUATION

Texas Guaranteed Student Loan Corporation

A Staff Report
to the
Sunset Advisory Commission

1988

TEXAS GUARANTEED STUDENT LOAN CORPORATION

March 1988

TABLE OF CONTENTS

	<u>Page</u>
Summary of Recommendations	1
Agency Evaluation	9
Background	11
Creation and Powers	13
Policy-making Structure	14
Funding and Organization	17
Programs and Functions	21
Review of Operations	29
Focus of Review	31
Policy-making Structure	34
The Composition of the Board Should be Changed	34
Advisory Committees Should be Required in Statute	37
Overall Administration	39
The State Auditor Should Review the Corporation's Audit	39
The Internal Auditor's Position and Duties Should be Statutory	40
Increased Efforts are Needed to Reduce the Guarantee Fee	42
Evaluation of Programs	50
School's Awareness of Responsibility for Defaults Should be Increased	52
Increased Lender Responsibility for Defaults is Needed	54
Actions Should be Taken to Increase Sanctions for Defaulted Borrowers	57
Use of State Professional Licensing Agencies Could Lower Default Rates	58
TGSLC Should Evaluate the Benefits of Using Private Collection Agencies	64
Other Changes	67
Minor Modifications of Agency's Statute	69
Across-the-Board Recommendations	73

Summary of Recommendations

The Texas Guaranteed Student Loan Corporation (TGSLC), created in 1979, administers the federal guaranteed student loan program in Texas and guarantees student loans under the terms of that program. The TGSLC is a public nonprofit corporation: it is not a state agency and receives no appropriations of state funds. The 11-member board of the Texas Guaranteed Student Loan Corporation is made up of eight members appointed by the governor for six year terms, the Comptroller of Public Accounts, a member of the Texas Higher Education Coordinating Board, and a student appointed by the Commissioner of Higher Education. The board hires an executive director who is chief executive officer of the corporation's 200 employees and \$12 million annual operating budget.

The corporation has only one office and is located in Austin. The corporation received an initial start-up appropriation from the state of \$1.5 million and approximately \$10 million in federal advances. Currently, the main sources of income are student loan guarantee fees, federal reinsurance receipts, federal administrative cost allowances, default recoveries, investments, and loan servicing fees. The corporation guaranteed over \$378 million in student loans in 1987 and over 1,800 schools and 600 lenders currently participate in the program.

The sunset review of the corporation's structure, administration, and programs concluded that the legislature's decision to establish a state chartered public nonprofit corporation, instead of a state agency, to administer the program still makes sense today. The review indicated that the corporation has fulfilled the purposes for which it was created and should be continued for a 12-year period.

The sunset review also determined that if the corporation is continued, a number of changes should be made to improve the efficiency and effectiveness of its operations. These changes are outlined below.

RECOMMENDATIONS

THE AGENCY SHOULD BE CONTINUED FOR A 12-YEAR PERIOD WITH THE FOLLOWING CHANGES:

Policy-making Structure

Composition of Board

1. **Statutory provisions regarding the make-up of the board of the TGSLC should be modified to provide for the following:**
 - **nine members with financial expertise appointed by the governor, one of whom shall be a full-time student;**
 - **no board member shall be either on the board or an employee of a participating school or lender or secondary market in the guaranteed student loan program; and**
 - **the Comptroller of Public Accounts, or his designee, shall serve as an ex officio voting member. (Statutory)**
(p. 35)

The board of the Texas Guaranteed Student Loan Corporation is currently composed of 11 members. Eight of these are appointed by the governor and the other slots are filled by a member of the Texas Higher Education Coordinating Board, a full-time student, and the Comptroller of Public Accounts. Of the governor appointed members, three must be from the field of commercial finance and three from higher education. The review determined that this composition has inherent conflicts of interest and that the board should instead be made up of a group of public members who are not representatives of institutions participating in the program.

Structure of Advisory Committees

2. **The TGSLC's school and lender advisory committees should be required in statute and clear statutory directives concerning the corporation's use of advisory committees should be established. (Statutory) (p. 38)**

The corporation's two existing advisory committees provide an effective means of providing input to the board from those directly affected by the board's decisions. These should be structured in statute and be made up of a balanced representation of the different types of lenders and schools participating in the program. The committees should be appointed by the board on the recommendation of the executive director.

Overall Administration

Oversight by State Auditor

3. **The corporation's statute regarding fiscal audits by a certified public accountant should be modified to provide that:**
 - **the state auditor shall approve the independent auditor selected by the agency to carry out its annual audit;**
 - **a copy of the annual audit shall be submitted to the state auditor for his review; and**
 - **the state auditor shall have the authority to examine any workpapers from the audit or conduct his own audit if his review of the independent audit indicates this need. (Statutory) (p. 39)**

The corporation's audit requirements could be improved by increasing the accountability of the agency to the state. This can be accomplished by involving the state auditor in the review of the audit currently conducted annually by a certified public accountant.

Functions of Internal Auditor

4. **The corporation's statute should be modified in the following ways to improve the corporation's use of its internal auditor:**
 - **require the appointment of the internal auditor by the executive director with the concurrence of the board;**
 - **require the internal auditor to report to the executive director but authorize the submission of reports**

directly to the board in situations specified by board rules;

- **require the board's executive committee to meet with the internal auditor on a regular basis; and**
- **clearly state the duties of the internal auditor to include the examination of the corporation's system of internal controls, as well as its system of identification of fixed and variable costs, including administrative costs. (Statutory) (p. 41)**

The TGSLC has recently hired the corporation's first internal auditor. By statutorily requiring this position and specifying the internal auditor's duties, an ongoing check over administrative costs and good management practices is ensured.

Guarantee Fees Charged to Students and Parents

5. **The statute should direct, as a matter of policy, that the board is to charge the lowest guarantee fee possible under federal requirements which will not endanger the fiscal viability of the corporation. (Statutory) (p. 44)**

The guarantee fee charged to the student or parent borrower represents the corporation's largest single source of income. This fee, however, increases the costs to students of obtaining a loan. Texas has a high effective insurance fee when compared to other large state programs. The statute should direct the corporation to keep this fee as low as possible to better serve Texas students.

6. **The board should evaluate the corporation's investment policy and make changes as needed. The evaluation should address:**
 - **the development of a plan to dispose of IBM and Exxon shares;**
 - **the benefits of authorizing longer term investments; and**
 - **the benefits of investing guarantee account funds with the Texas Treasury Safekeeping Trust Company. (Management Improvement) (p. 45)**

Improving the rate of return on the corporation's investments is one way to hold down the guarantee fees. Increasing revenues from other sources, such as investments, decreases the reliance on guarantee fees to fund the reserve. The corporation's investment policy has not been revised since 1984 and needs to be re-evaluated. Special consideration should be given to lengthening the maturity dates

on some investments. In addition, the corporation does not have statutory authority to hold equities and should take steps to dispose of these types of instruments. The potential benefits of investing through the state treasury should also be examined and considered.

7. **The statute should authorize the TGSLC to do need analysis for student financial aid and to become a Multiple Data Entry (MDE) processor used in determining Pell Grant Awards. It should also authorize TGSLC to service other states' guaranteed student loans. Prior to engaging in these activities, the board must find that the revenues collected will be enough to cover costs and reduce students' guarantee fees.**
(Statutory) (p. 48)

In addition to revising its investment policy, the TGSLC should have the statutory authority necessary to develop alternative revenue sources to help keep students' guarantee fees to a minimum. Three potential sources of revenue which are compatible with the corporation's mission of making higher education available for students are conducting student financial aid need analysis, multiple data entry processing for Pell Grant award determinations, and providing services related to guaranteed student loans for other states. Requiring the board to examine the costs and benefits of any new activity ensures that each option will be carefully studied.

Evaluation of Programs

Controlling Loan Defaults

Schools' Responsibility for Defaults

8. **The corporation should be required by statute to notify all schools of their default rates at least twice a year.** (Statutory)
(p. 52)

The TGSLC is currently authorized under federal regulations to notify schools of their default rates and required to respond to any requests for this information. The corporation currently only responds to information requests. Requiring the semi-annual reporting of default rates would increase schools' awareness of the problem and facilitate the schools' cooperation.

9. **The corporation's statute should clearly indicate that default rates higher than 20 percent (as currently defined for schools by TGSLC) may be grounds for limitation, suspension, or termination from the program. (Statutory) (p. 52)**

The TGSLC's current policy regarding schools' eligibility for participation in the loan program expressly states that a high default rate alone is not a criterion for eligibility. While student characteristics are the strongest predictors of loan defaults, school administrative practices do have some influence on the default rate. Changing the current TGSLC policy sends schools the message that they are expected to take whatever actions possible to reduce defaults.

Lenders' Responsibility for Defaults

10. **The corporation's statute should clearly indicate that default rates higher than 15 percent may be grounds for limitation, suspension, or termination from the program. (Statutory) (p. 54)**

Currently, as long as lenders in the program comply with "due diligence" standards in making and trying to collect on loans, they are reimbursed for 100 percent of all defaults. The TGSLC has a policy that a lender participating in the program should generally have a default rate less than 15 percent of the loans it makes. That policy is not being enforced and ten percent of the Texas lenders currently have defaults higher than 15 percent. Since this is the one area where the corporation can directly limit the amount of claims it has to pay, the TGSLC should begin to enforce this policy.

Sanctions for Defaulted Borrowers

11. **The TGSLC loan application/ promissory note should contain a valid wage garnishment waiver agreement for state employment. (Management Improvement) (p. 57)**
12. **The corporation's statute regarding comptroller warrant holds should be amended by adding the qualifier "unless failure to issue the warrant would violate the Texas Constitution." (Statutory) (p. 58)**

The TGSLC's statute currently requires the Comptroller of Public Accounts to not issue warrants to persons the TGSLC has identified as being in default on a guaranteed student loan. Under the Texas Constitution, however, warrants for current wages cannot be withheld unless the employee has signed a valid waiver

agreement. Incorporating the waiver agreement into the loan application would solve this problem. In addition, the statute should be amended to reflect the current constitutional prohibition to wage garnishment yet allow the provision to be enforced should the constitution ever be changed.

Role of Professional Licensing Agencies in Reducing Defaults

13. State professional and occupational licensing statutes should be modified to:

- **establish that defaulting on a guaranteed student loan is a ground for not issuing or renewing the license;**
- **require licensing agencies to collect and submit to the TGSLC licensee or applicant information (full name, social security number, date of birth, etc.) needed to match TGSLC borrower data; and**
- **require licensing agencies to cooperate with the TGSLC and take actions to deny or revoke licensure for those persons in default on guaranteed student loans. (Statutory) (p. 59)**

Many persons use guaranteed student loans to get an education to enter an occupation or profession which is regulated by the state. Amending state professional and occupational licensing statutes to make defaulting on a guaranteed student loan a ground for not issuing or renewing the license would increase the sanctions available for defaulted student loan borrowers and discourage future defaults. The responsibility for checking the information and determining if a licensee had defaulted on a student loan would be the TGSLC's.

Use of Private Collection Agencies

14. The TGSLC should evaluate the costs and benefits of using private collections agencies to assist in collecting on defaulted student loans. (Management Improvement) (p. 64)

The corporation currently pursues all collections activity through an in-house operation. The U.S. General Accounting Office reports that most other guarantee agencies supplement their in-house efforts by using private collection contractors. The TGSLC should formally study this alternative to see if it might produce results in Texas.

AGENCY EVALUATION

Background

Creation and Powers

The Texas Guaranteed Student Loan Corporation (TGSLC) was created by the 66th Texas State Legislature in 1979. The corporation was created as a public nonprofit entity to administer the federal guaranteed student loan program in Texas and to guarantee student loans under the terms of that program. The corporation does not make any loans itself, it guarantees loans made by financial institutions and the Texas Higher Education Coordinating Board against the death, disability or default of the borrower. In that sense, the TGSLC acts like an insurance company.

The TGSLC is not a state agency and receives no appropriations of state funds. The corporation is subject to the Texas Sunset Act however. In addition, an attorney general opinion found that the TGSLC is subject to the Texas Open Records Act because of an initial appropriation of lender's allowance funds from the Texas Higher Education Coordinating Board made to help establish the corporation.

The original national guaranteed student loan program was created by the federal 1965 Higher Education Act as a way of removing financial barriers to higher education opportunities. Under the loan guarantee program, the government initially encouraged private lenders to make loans available to students by providing an 80 percent guarantee that the lender would be reimbursed should the student not repay the loan. Other incentives to lenders to make capital available for student loans included a federal interest subsidy that made the return on the loans attractive and the existence of secondary market agencies whose primary purpose was to purchase guaranteed student loans from lenders. Secondary markets provided smaller lenders with needed liquidity of their assets. However, even with these incentives, the participation of lenders in the program did not keep up with the demand for student loans. It was determined that the high degree of centralization in the federal student loan insurance program was hindering its growth. Lenders had to wait too long to have a claim for reimbursement on defaulted loans processed and often had claims rejected. Consequently, the Higher Education Act Amendments of 1976 created financial incentives to states to create guarantee agencies which would administer the guaranteed student loan program at the state level. These incentives included federal advance funds to help establish the agency, 100 percent reinsurance on all defaults for the first five years of the program, and administrative cost allowance funds. In addition, the lender's guarantee was increased to 100 percent. As a result of these financial incentives being offered, the Texas legislature commissioned an interim study conducted in 1978 by the

accounting firm of Touche Ross & Co. The study evaluated alternatives for a student loan guarantee program in Texas and the creation of the TGSLC in its present form was recommended by that study.

Since the incentives were offered to set up state guarantee agencies, all fifty states, the District of Columbia, Puerto Rico, Guam, American Samoa, North Marianas and the Trust Territories have established a guarantee agency or designated one of two national private nonprofit guarantee agencies as their guarantor. Twenty five states and Puerto Rico have designated a state agency to be the guarantee agency, 18 states, including Texas, have established nonprofit corporations as guarantee agencies, and 7 states and the District of Columbia have designated one of the national private guarantee firms (Higher Education Assistance Foundation or United Student Aid Funds).

Currently, the guaranteed student loan program represents the largest student financial assistance program in the state, as well as in the nation. The TGSLC guarantees the principal and accumulated interest to private lenders for each eligible student loan they make. Participation in the program and loans guaranteed have grown steadily since the TGSLC was created, as seen in Exhibits 1 and 2. The drop in the number of lenders participating in the program in 1987 (Exhibit 2) is due, in part, to an increase in Texas bank failures and mergers, and to smaller lenders dropping out as large "open-door" lenders have entered the student loan market.

Policy-making Structure

The board of the Texas Guaranteed Student Loan Corporation is composed of 11 members. Eight of these are appointed by the governor with the advice and consent of the senate, and serve for six year terms. Three of the governor appointees must be from the field of commercial finance, three must be members of the faculty or administration of an eligible post-secondary institution, and two must be public members not affiliated with either commercial finance or higher education. In addition, a student appointed by the Commissioner of Higher Education sits on the board and serves for a six year term (or as long as that person is a full time student). Thus, nine members serve staggered six year terms. The other two positions on the board are filled by the Comptroller of Public Accounts, and a member of the Texas Higher Education Coordinating Board, appointed by the chairman of the Coordinating Board, who serve in an ex officio capacity.

Exhibit 1

Annual and Cumulative Student Loans Guaranteed

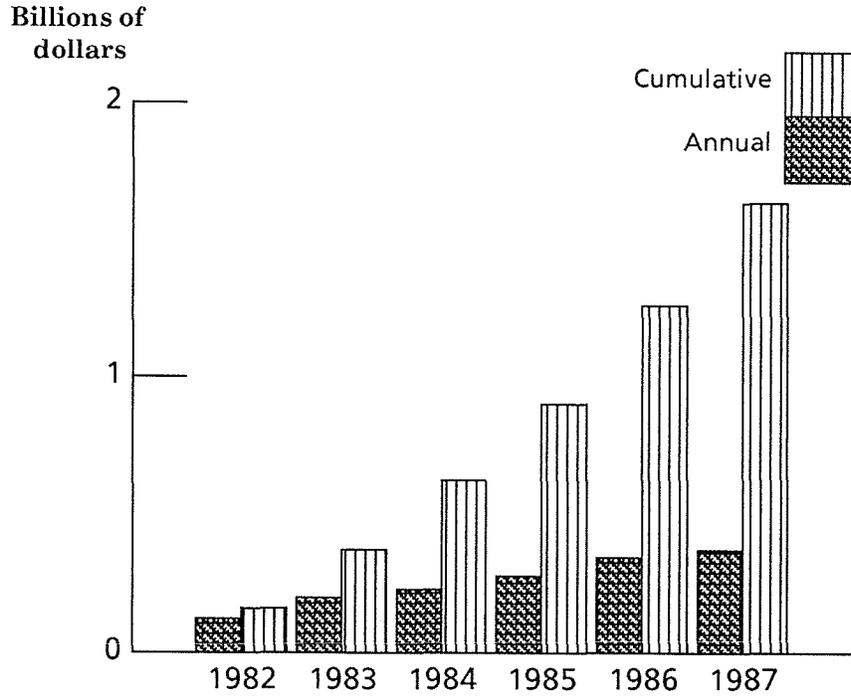
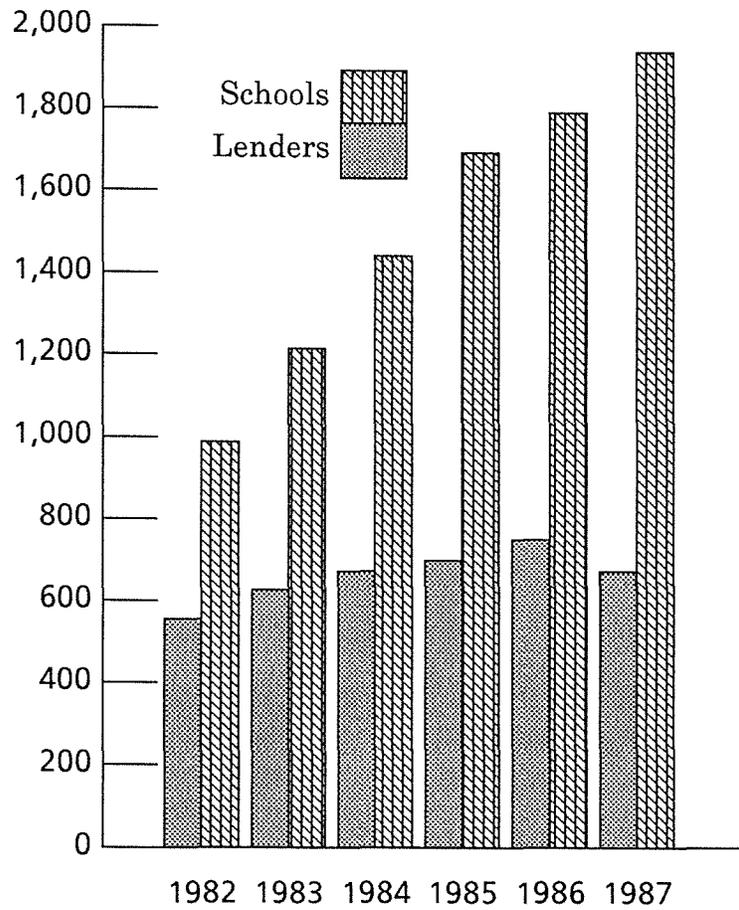


Exhibit 2

Eligible Lenders and Schools in the Program



Funding and Organization

The headquarters and only office of the Texas Guaranteed Student Loan Corporation is located in Austin, as required by statute. The corporation employs approximately 200 full time employees and owns the building which it occupies. The employees are not state employees and the corporation has its own retirement and benefits programs. The operating budget for the corporation in its fiscal year ending September 30, 1987 was \$10 million and the budget for fiscal year 1988 is \$11.6 million. Exhibit 3 shows the organizational structure of the corporation.

When the TGSLC was created the Texas legislature appropriated \$1,500,000 to it from the federal special lender's allowance fund at the Coordinating Board. This fund had a balance at that time of over \$4 million and represented earnings from the state's direct student loan program. This was a one-time appropriation designed to provide the total funds necessary for the TGSLC to become a self-sustaining entity.

In addition to this start up appropriation, the TGSLC was eligible to receive two types of federal advance funds under sections 422(a) and 422(c) of the Higher Education Act of 1965. These advance funds were made available by the federal government for the purposes of helping regional guarantee agencies get established and build up adequate reserve funds. The TGSLC received approximately \$10 million in federal advances which may be recalled. Consequently, these funds are segregated in the TGSLC's reserve fund as contingent liabilities.

By state law, the TGSLC reserve fund is divided into two accounts: the operating account and the guarantee account. Income to the corporation in the form of insurance premium receipts from students, federal administrative cost allowances, the corporation's share of collections on defaulted loans, and loan servicing fees is deposited to the operating account, from which the corporation's operating expenses are paid. The federal advance funds, federal reinsurance receipts, investment earnings and corporate earnings not needed for operations are deposited into the guarantee account. Funds may be withdrawn from the guarantee account for the sole purpose of paying lenders' claims on defaults. The TGSLC board has a policy of maintaining reserves equivalent to 1.5 percent of outstanding loans. The relationship between outstanding loans and reserves is shown in Exhibit 4. This reserve is the guarantee fund balance, as illustrated in Exhibit 5. Management transfers funds into the guarantee account, according to a complex financial forecasting model, to maintain the proper allowance for defaults.

Exhibit 3

Texas Guaranteed Student Loan Corporation

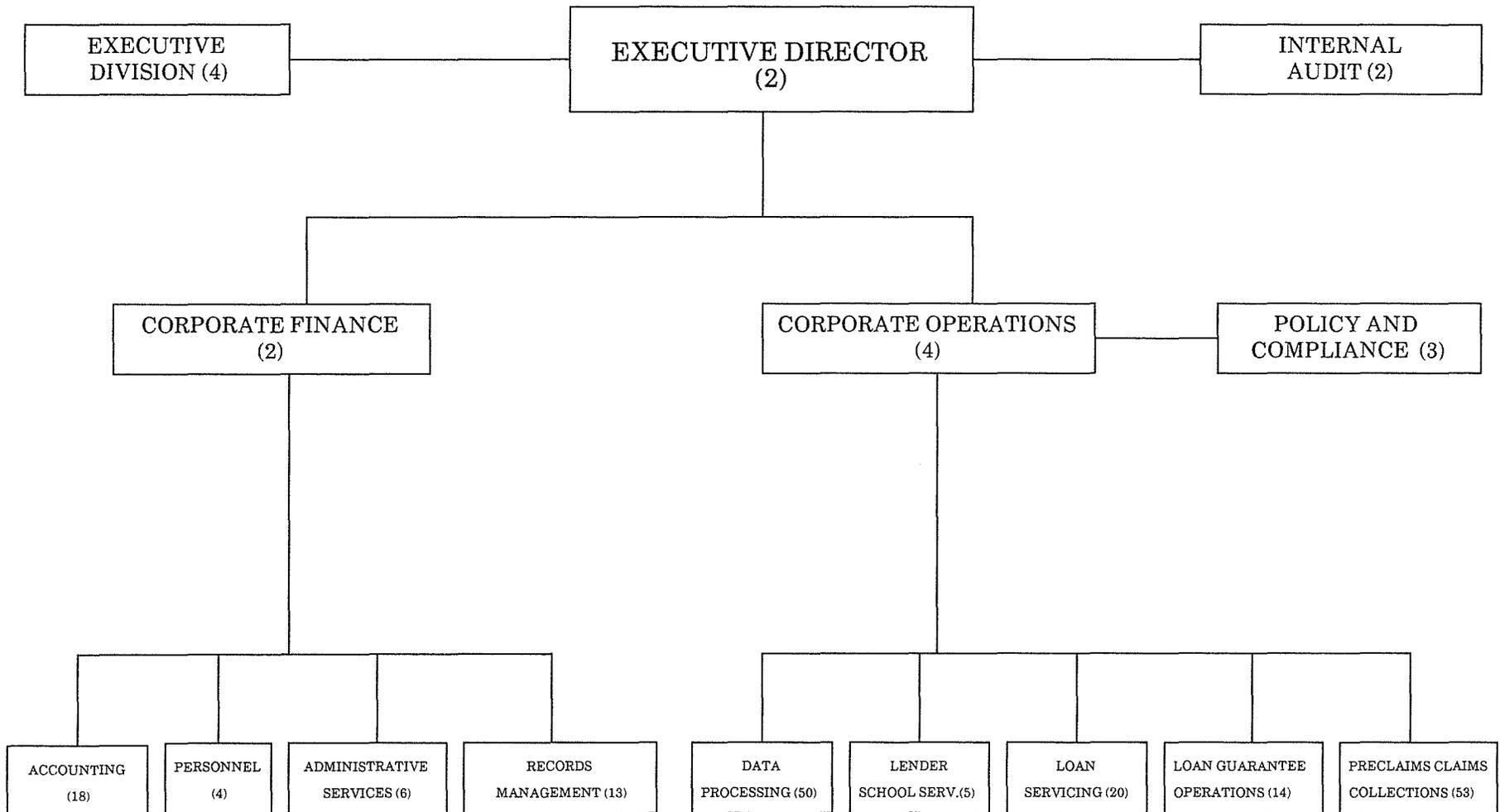


Exhibit 4

Actual and Projected Corporate Reserves Versus Total Outstanding Loan Principal

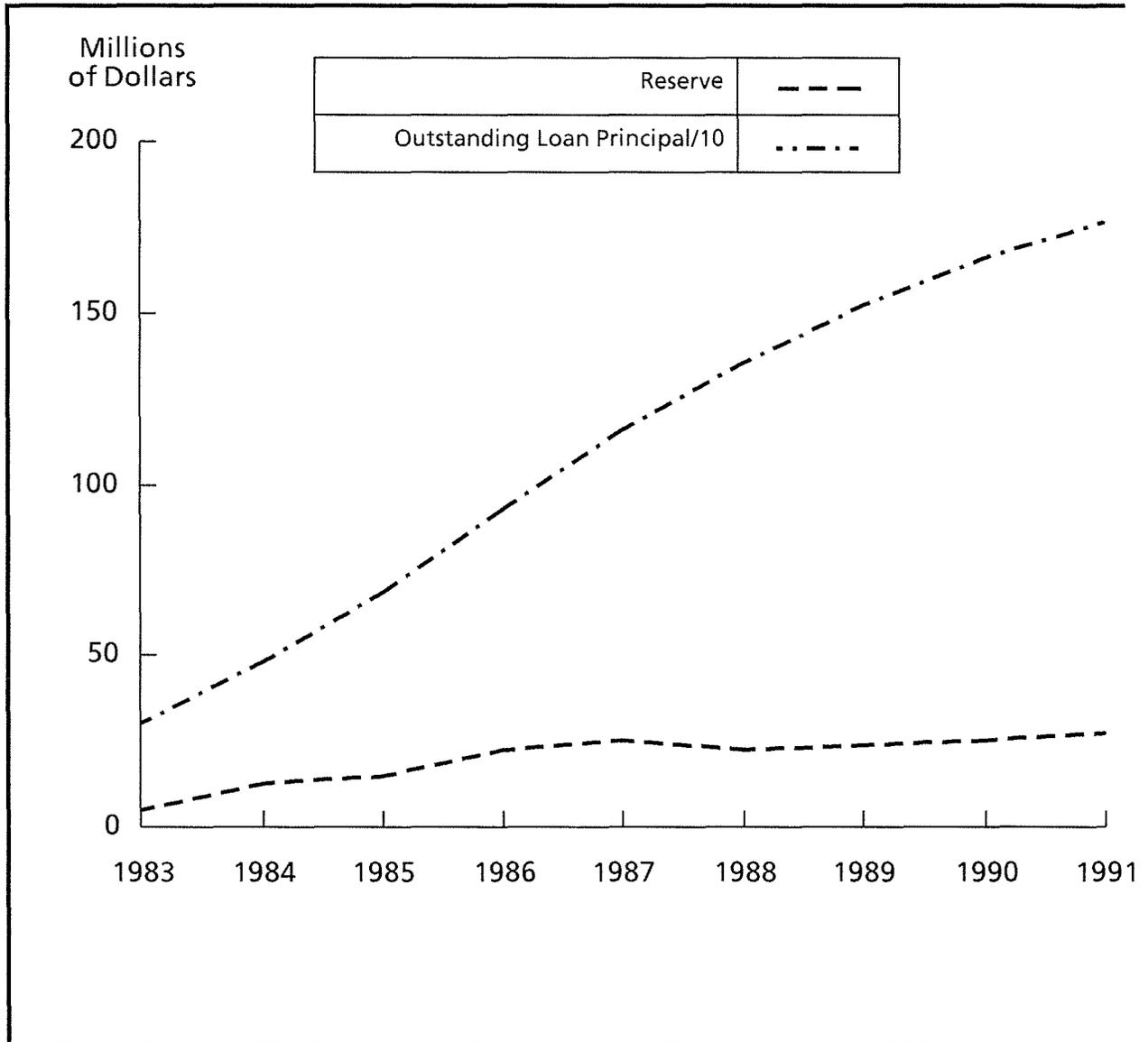


Exhibit 5
TGSLC Revenues and Disbursements

	<u>FY 1986</u>	<u>FY 1987</u>	<u>FY 1988 (estimated)</u>
<u>Operating Account</u>			
Cash-Beginning	\$ 3,600,345	\$ 5,107,815	\$ 5,925,803
Guarantee Fees	7,133,928	8,192,880	7,897,366
Administrative Cost Allowance	4,348,410	4,215,937	3,499,907
Loan Servicing	117,487	365,725	1,750,000
Investments	441,142	382,072	490,450
Recoveries	550,016	1,314,219	2,578,399
Rental/Loans/Others	<u>1,124,869</u>	<u>0</u>	<u>0</u>
Cash Available	\$ 17,316,197	\$ 19,578,648	\$ 22,141,925
Less:			
Operating Budget	8,611,827	9,932,271	11,551,842
Reinsurance Fee	0	0	1,891,503
Loan Principal	559,755	220,158	105,000
Transfer Out	<u>3,036,800</u>	<u>3,500,416</u>	<u>2,258,121</u>
Cash-Ending	<u>\$ 5,107,815</u>	<u>\$ 5,925,803</u>	<u>\$ 6,335,459</u>
<u>Guarantee Account</u>			
Cash-Beginning	\$ 10,899,615	\$ 16,713,753	\$ 13,322,322
Reinsurance	30,486,046	43,548,771	63,585,923
Investments	1,726,100	882,197	1,184,023
Transfer In	3,036,800	3,500,416	2,258,121
Federal Advance	3,961,158	0	0
Other	<u>75,744</u>	<u>0</u>	<u>0</u>
Less:	\$ 50,185,463	\$ 64,645,137	\$ 80,350,389
Claims Reinsured	32,333,014	49,020,629	64,808,015
Claims Non-Reinsured	<u>1,138,696</u>	<u>2,302,186</u>	<u>4,304,823</u>
Cash-Ending	\$ 16,713,753	\$ <u>13,322,322</u>	\$ 11,237,551
Receivables	<u>\$ 6,815,897</u>	<u>\$ 11,959,299</u>	<u>\$ 13,207,202</u>
Guarantee Reserve	<u>\$ 23,529,650</u>	<u>\$ 25,281,621</u>	<u>\$ 24,444,753</u>
TOTAL RESERVES	\$ 28,637,465	\$ 31,207,424	\$ 30,780,212
Outstanding Loans (Millions \$)	\$ 837.80	\$ 1,021.80	\$ 1,339.50
Guarantee Reserve Percent (Guarantee Reserve/Outstanding Loans)	2.81%	2.47%	1.82%

The TGSLC is limited by statute to investing in United States government securities such as treasury bills and securities of federally backed agencies like Fannie Mae. The investment policy adopted by the corporation specifies the types of investments the corporation will make in order to maintain liquidity and limits the investment maturities to three to five years.

Programs and Functions

Loan Guarantee Operations. The main function of the TGSLC is to guarantee student loans under the terms of the federal guaranteed student loan program. The guaranteed student loan program consists of three student loan components: the Guaranteed Student Loan Program (GSLP), which is the original loan program created in 1965; the Parent Loan for Undergraduate Students Program (PLUS), created in 1980 to encourage loans to parents of dependent undergraduate students; and the Supplemental Loan for Students Program (SLS), created in 1986 to encourage loans for independent students. The features of these three programs are summarized in Exhibit 6. From an operational standpoint, the TGSLC guarantees loans under the three components in the same way, therefore there is no differentiation among the three in terms of corporate staff, income, or expenses.

The loan guarantee function operates as follows. First a student undergoes a financial needs assessment processed by a national firm, which forwards the results to the school financial aid office indicated by the student. An overall determination of the student's need is made by a financial aid officer who then prepares a financial aid package for the student, first offering whatever grant or scholarship aid may be available. Student loans are offered as a last alternative to make up the difference between the student's resources, expected work earnings, and gift aid and the expected costs of attending the institution. The student completes the loan application and the school certifies that the student is at least a half time student and meets the financial need criteria. The student then takes or mails the application to a participating lender who may accept or deny the application, depending on the lender's own criteria. If accepted, the lender forwards the loan application to the TGSLC. The TGSLC processes the application on its computer system which has various automated editing checks to see that the application meets all the eligibility criteria and checks to see if the student has ever previously defaulted on a TGSLC guaranteed loan. If all the requirements are met, the TGSLC

Exhibit 6

Texas Guaranteed Student Loan Corporation Loan Program Components

	Texas Guaranteed Student Loan Program (TGSL)	Texas Supplemental Loans For Students (TSLs)	Texas Parent Loan Program (TPLUS)
Eligible Borrowers	<ul style="list-style-type: none"> • Undergraduate and graduate students who <ul style="list-style-type: none"> - are citizens or eligible non-citizens, - enrolled at least half time or accepted for enrollment in an eligible school - making satisfactory progress and in good academic standing, if applicable - having no defaults on prior NDSL (or Perkins Loans), FISL, GSL, SLS, ALAS, or PLUS loans and owing no refunds on Pell, SEOG, or SSIG Grants, - registered with the U.S. Selective Service System, and - who certify their intent to use the loan proceeds for educational purposes 	<ul style="list-style-type: none"> • Available to borrowers who are not eligible for Guaranteed Student Loans and/or those who need funds in addition to their GSL and/or PLUS borrowings • Other requirements are the same as those for TGSL 	<ul style="list-style-type: none"> • Available to borrowers who are not eligible for Guaranteed Student Loans and/or those who need funds in addition to their GSL and/or SLS borrowings • Parents of dependent undergraduate, graduate or professional students <ul style="list-style-type: none"> - who are citizens or eligible non-citizens, - who have no defaults on prior NDSL (or Perkins Loans), FISL, GSL, SLS, ALAS or PLUS loans and owe no refunds on Pell, SEOG, or SSIG Grants, - who have stated their intent to apply the proceeds to the educational costs of the student, and - whose dependent undergraduate student(s) meet all the criteria outlined for the TGSL eligibility
Financial Eligibility	<ul style="list-style-type: none"> • Determined by the school based on an analysis of student "need" which considers the family financial condition, estimated cost of education, and eligibility for other financial aid 	<ul style="list-style-type: none"> • Same as TGSL 	<ul style="list-style-type: none"> • Determined by the school based on an analysis of student "need" which includes estimated costs of education less other financial aid • Financial capacity to repay the loan is determined by the lender

Exhibit 6

Texas Guaranteed Student Loan Corporation Loan Program Components

	Texas Guaranteed Student Loan Program (TGSL)	Texas Supplemental Loans For Students (TSLs)	Texas Parent Loan Program (TPLUS)
Interest Rate, Fees and Repayment Responsibilities	<ul style="list-style-type: none"> 8 % interest rate Guarantee fee not to exceed 3 % of principal amount (currently 2.25%) Origination fee, currently 5% of principal amount No payment of principal required during the student's in-school period plus six months; interest subsidized by the U.S. Government during this time Borrower payment of principal and interest begins after school is completed 	<ul style="list-style-type: none"> Annually adjusted variable rate not to exceed 12% Guarantee fee not to exceed 3% of principal amount (currently 2.25%) Borrower payment of principal and interest begins within 60 days of loan disbursement. SLS borrowers are eligible for certain deferments, including full-time enrollment at an eligible school. Deferment entitles borrowers to postponement of principal payments. Interest must be paid or capitalized to principal 	<ul style="list-style-type: none"> Annually adjusted variable rate not to exceed 12% Guarantee fee not to exceed 3% of principal amount (currently 2.25%) Borrower payment of principal and interest begins within 60 days of loan disbursement. The only deferment currently available to parent borrowers is for unemployment. Additional deferments will be added for "new" borrowers beginning July 1, 1987. Deferment entitles borrowers to postponement of principal payments. Interest must be paid or capitalized to principal.
Maximum Loan Amounts	<ul style="list-style-type: none"> Freshmen, Sophomores \$2,625 annually Juniors, Seniors \$4,000 annually Cumulative Undergraduate \$17,250 total Graduate/Professional \$7,500 annually Cumulative Graduate/Professional \$54,750 (total includes undergraduate GSL, SLS and student PLUS borrowings) 	<ul style="list-style-type: none"> \$4,000 annually (in addition to GSL and/or PLUS borrowing) \$20,000 cumulative total 	<ul style="list-style-type: none"> \$4,000 annually per dependent student (in addition to GSL and/or SLS borrowing) \$20,000 cumulative total per dependent student
Repayment Terms	<ul style="list-style-type: none"> \$50 per month minimum Ten year maximum repayment term 	<ul style="list-style-type: none"> Same as TGSL 	<ul style="list-style-type: none"> Same as TGSL

then issues the guarantee and sends a notice of guarantee back to the lender. The loan guarantee processing operates 24 hours a day, employs 15 people, and the current turnaround time at TGSLC to process a guarantee is 48 hours. When the lender receives the loan application back with the guarantee, he issues a check in the student's name -- after first deducting the loan insurance and origination fees from the loan amount -- and sends the check to the school's financial aid office. The total elapsed time between the student's submission of the application to the lender and the arrival of the check at the financial aid office is approximately seven days. The loan insurance fee is sent to TGSLC and the origination fee is applied to the first federal interest subsidies the lender will receive. For an average \$2,000 student loan, the student would receive \$1,855 after the insurance fee of \$45 and the origination fee of \$100 were deducted.

Loan Servicing. In 1982 the TGSLC board, under statutory authority, began a loan servicing program for lenders in order to attract more lenders into the program. The servicing of guaranteed student loans does not fit well with the servicing of a lender's traditional commercial lending portfolio. The guaranteed student loans are subsidized loans, of a generally small amount, and are very long term. In addition, there are numerous "due diligence" procedures that must be followed and documented. These due diligence procedures include a series of letters and phone calls to the delinquent borrower that the lender must make in an effort to collect on the loan prior to filing a claim with the TGSLC. The steps are illustrated in Exhibit 7. Consequently, many smaller lenders find it more economical to pay a servicer to service guaranteed student loans. The TGSLC offers this service to participating lenders; there are also other national firms that offer this service. For the loans it services, the TGSLC will bill the federal government quarterly for interest and special allowances due the lender, process deferments, collect the payments and wire transfer them to lenders, process forbearances, perform all the due diligence requirements, and prepare and file claims if necessary. The TGSLC bills each lender monthly for servicing. Loan servicing is a fast growing function of the TGSLC. In fiscal year 1988, net revenues of approximately \$800,000 are expected and 19 new full time employees will be added to the 20 employees that currently carry out this function. Income from loan servicing helps to offset the corporation's large investment in data processing (51 employees) which supports the loan guarantee, loan servicing, and claims activities.

Exhibit 7

TGSLC Lender Due Diligence Process

Days of Delinquency on the Loan	Action
0 to 30	Two notices
30 to 60	One phone contact and two letters
60 to 90	One phone contact and one letter Request for TGSLC assistance
90 to 120	One phone contact and one letter Request for TGSLC assistance
120 to 150	One phone contact and one letter
150	Demand letter is sent to borrower
180	First day to file claim with TGSLC

Preclaims, Claims, and Collections. This department is responsible for helping lenders prevent defaults on loans, for processing lender claims once a default occurs, and for collecting claims on defaulted guaranteed student loans. Fifty-three people work in this area. The preclaims process is initiated when a lender notifies the TGSLC that an account is 60 days past due and files a request for assistance. The preclaims staff contact the borrower and generally supplement the activities of the lender in trying to collect the loan payments by making phone calls and sending letters. At 180 days past due, after the lender has issued a demand letter to the student calling in all the loan, the lender may file a claim with the TGSLC. The lender must file the claim before the 220th day past due and the average claim is filed at the 210th day. The lender signs over the promissory note and the documented account history which is reviewed at TGSLC. Data is entered into an automated system that checks the claim to verify that all the due diligence procedures have been followed by the lender. If they have, a check is issued automatically to the lender. This process takes from 24 hours to 10 days from receipt of the claim. A new expedited process is being introduced for lenders with historically low claims rejections rates that will reduce the number of TGSLC personnel involved in claims review and allow them to focus more on preclaims and collections activities.

TGSLC may not bill the federal government for claims reinsurance until the 270th day of delinquency, and usually receives the reimbursement around the 330th day of delinquency. Since the TGSLC pays the claim to the lender around the 220th day of delinquency, there is a "float period" of approximately 110 days for \$10 to \$15 million which the TGSLC must cover with its own funds.

Secondary Markets. Student loans are unlike any other type of commercial loans that lenders make since they are for relatively small amounts and have very long repayment periods. A student has up to ten years to repay the loan and the repayment period doesn't begin until six months after graduation or leaving school. In addition, there are 19 types of deferments available to students in special categories. For example, loan repayment may be deferred if a student goes to graduate school, joins the armed forces, becomes unemployed or takes parental leave. These deferments prolong the loan repayment period and make handling student loans all the more difficult. Consequently, the Congress established the Student Loan Marketing Association (Sallie Mae) to purchase student loans from lenders, thereby providing lenders the necessary liquidity on their investment. Sallie Mae is thus a secondary market for student loans. Sallie Mae is a private corporation, financed by private capital, which received federal fund advances and administrative allowances to help get it established. In addition to Sallie Mae, Texas statutes authorize the creation of local Higher Education Authorities which function as regional "mini Sallie Maes." The authorities are created by the governing body of a city (or cities), usually near a large university, and issue revenue bonds for the purpose of purchasing guaranteed student loans from local lenders. There are nine Higher Education Authorities in Texas. A local lender in Texas then has three possible purchasers of his student loan portfolio: the authorities, Sallie Mae, or any other eligible lender. Many lenders sell their student loans to a secondary market, unless their student loan volume is large enough that they can achieve the economies of scale needed to make holding the loans profitable. Although secondary market agencies are not recognized as eligible lenders in the guaranteed student loan program (they must operate through a designated trustee bank), they must meet the same due diligence requirements of primary lenders and the guaranteed student loans they purchase retain the original guarantee of 100 percent insurance.

Loan Consolidation. Students can find themselves after graduation making monthly payments on several guaranteed loans, all to different lenders or secondary market agencies. Under the federal regulations of the guaranteed student loan

program, lenders may provide loans to certain borrowers to consolidate the borrower's student loan obligations into one monthly payment to one institution. This consolidation must be initiated at the borrower's request and the borrower must have at least \$5,000 in outstanding loans, be in repayment status, and not be delinquent on any account. Loan consolidation does not apply to parent loans. Guarantee agencies, such as the TGSLC, may sign agreements with eligible lenders and secondary market agencies and issue certificates of comprehensive insurance coverage for the purposes of loan consolidation. The TGSLC is currently entering into such agreements with some lenders on an experimental basis, primarily as a service to them, since the guarantee agency may not charge any fees for guaranteeing consolidated loans.

Lender of Last Resort. The federal guaranteed student loan program statutes require that each state designate a lender of last resort: either the guarantee agency itself; or another eligible lender in the state through an agreement with the guarantee agency. The TGSLC was designated the state's lender of last resort by the state legislature in 1985. The lender of last resort provisions require the TGSLC to make a guaranteed student loan to any eligible student who certifies that no other eligible lender in the state, nor the Texas Higher Education Coordinating Board, is willing to make a guaranteed student loan to that student. To date, the TGSLC has not made any loans as a lender of last resort because there are many lenders in the state who will make guaranteed student loans to any eligible student.

Review of Operations

Focus of Review

The Sunset staff review of the Texas Guaranteed Student Loan Corporation included all aspects of the corporation's activities and focused on the appropriateness of the structure and non-state agency status of the corporation and ways to improve the operations of the corporation to more effectively carry out its student loan guarantee function. A number of activities were undertaken by the staff to gain a better understanding of the corporation. These activities included:

- discussions with key corporation staff;
- discussions with five board members individually;
- visits to two lender operations, one higher education authority and two schools;
- review of past legislative issues and relevant evaluation studies and reports;
- phone discussions with officials of guaranty agencies in six other states; and
- discussions with persons in other state agencies knowledgeable of the corporation's development and functions.

These activities yielded an understanding of the general objectives of the corporation's functions and the key issues related to the corporation and the state/federal partnership that exists to carry out the guaranteed student loan program. The issues identified generally fall into three related areas of inquiry. First, is the structure adopted for the state's guarantee program in 1979 still the best alternative for the state? Second, are changes needed in the state's overall approach to student financial aid? Third, what changes are needed to improve the corporation's overall performance and accountability to the state without changing its status as a public nonprofit corporation?

Regarding the first area of inquiry, an extensive review has been made of the work of the interim committee which investigated options for establishing a guarantee agency in Texas following the 1976 Higher Education amendments in Congress. These amendments provided many federal incentives to states to establish guarantee programs. The recommendations and expectations of that committee have been measured against the corporation's seven year track record to determine if the committee's and the legislature's decision to establish a state chartered public nonprofit corporation, instead of a state agency, to administer the

program still makes sense today. In summary, the review indicates the decision was a wise one:

- trends in other states indicate that the use of nonprofit agencies, like the TGSLC, has grown from 10 states in 1985 to 18 states in 1987 while the use of state agencies in the program has decreased from 35 to 25 in the same period. No state has converted a nonprofit guarantee agency into a state agency;
- loan capital available to students has increased from \$40 million in 1981 to over \$378 million in 1987 demonstrating lender satisfaction with the program and that any eligible student can now obtain a guaranteed student loan;
- the corporation has operated successfully without state appropriations, has built up a loan insurance reserve fund of approximately \$25 million and has not incurred any liability for the state;
- entire elimination of the program would force the federal government to designate a guarantor from another state which would reduce the service and attention to Texas lenders, schools, and students, and would likely adversely affect the lender participation in the program;
- no substantial benefit to the state could be identified by making the corporation a state agency. Although changes are needed to improve the corporation's operations, they can be implemented through modifications of the corporation's existing statutes.

Regarding the second area of inquiry, the review identified several issues relating to the state's student financial aid system. There are basically three types of post-secondary student financial assistance. These are grants or scholarships, work-study programs, and loans. There are different sources of funding for the three types of aid. Both independent and state-supported colleges and universities sponsor financial aid programs for students at their institutions. Federal government assistance includes need-based programs such as Pell Grants, Health Professional Student Loans, Nursing Student Loans and Scholarships, and the College Work-Study Program. At the state level, a major source of funding is through programs administered by the Texas Higher Education Coordinating Board. These programs have been established to address specific needs in Texas. The largest state programs include the Tuition Equalization Grant Program (TEG), the Texas Public Education

Grant Program (TPEG), and the Hinson-Hazelwood College Student Loan Program. The Hinson-Hazelwood program is one of 676 lenders that a student may approach to get a guaranteed student loan. Approximately two percent of the loans guaranteed by the TGSLC in fiscal year 1987 were made by the Coordinating Board through Hinson-Hazelwood.

The select committee on higher education recommended consolidation of all student financial aid programs in Texas. Bills were introduced during the 70th Legislature that would have a) consolidated the programs under the Coordinating Board, b) consolidated the programs under the Texas Guaranteed Student Loan Corporation, or c) created a new state agency to administer the programs currently handled by the Coordinating Board and the TGSLC. These bills either did not pass or the portion dealing with financial aid was removed. Since the decision on these issues will significantly affect both the TGSLC and the Coordinating Board, their further review and resolution should occur during the sunset review of the Coordinating Board.

The Coordinating Board is scheduled for review later this cycle and will be an appropriate time to examine the entire student financial aid system in light of the following questions:

- would consolidation simplify the financial aid process for students and parents;
- have other states consolidated functions and realized beneficial results;
- what agency should have the responsibility for student financial aid programs, if consolidated; and
- what are the cost-benefits to the state of consolidation?

Answers and recommendations related to these and other pertinent functions will be developed and presented to the Sunset Commission as work is completed on the Coordinating Board review.

Regarding the third area of inquiry, numerous modifications in the corporation's current operations and statutory structure were identified which would improve the corporation's accountability to the state and its overall performance. The following recommendations have been developed to fully explain the modifications needed.

Policy-making Structure

The statute setting up the corporation's policy-making structure should satisfy five requirements. First, the board should be structured to provide effective state oversight of the corporation's activities. Second, the statute should provide for board members with an appropriate amount of experience relevant to the corporation's functions but free of inherent conflicts of interests. Third, the statute should give the board clear direction regarding its policy role in the corporation. Fourth, the board should be of sufficient size to handle its workload and conduct its business efficiently. Finally, the statute should provide clear authority for the board's advisory committees and outline how the committees will assist and interact with the board.

The review indicated that the operation of the corporation appropriately separates the board's policy role from the day-to-day management role of its staff. The 11-member size of the part-time board is also appropriate. It is of sufficient size to handle its workload, while not too large to function effectively. Additionally, the appointment of the board by the governor and its confirmation by the Senate, provides an effective mechanism for state oversight of the corporation's activities.

The review did find, however, that the current qualifications for board members do include inherent conflicts of interests which need to be adjusted. Further, the statute provides no guidance on how the board should use advisory committees nor any authority for the board's two existing advisory committees. Recommendations to address these concerns are set out below.

The Composition of the Board of Directors Should be Changed

The current composition of the board is the same as that initially proposed in the first draft of the legislation to set up the corporation. The interim study which led to the TGSLC's creation and outlined proposed legislation did not specify who should be on the board, only that the legislation should define the number, backgrounds, and terms of the board members. The review of the TGSLC examined the current composition of the board of directors to determine if it is the most appropriate one. The review found that while the members that have been appointed to the board have all fulfilled their duties conscientiously, changes in the composition could eliminate any appearance of conflicts of interest.

Statutory provisions regarding the make-up of the board of the TGSLC should be modified to provide for the following:

- nine members with financial expertise appointed by the governor, one of whom shall be a full-time student;
- no board member shall be either on the board or an employee of a participating school or lender or secondary market in the guaranteed student loan program; and
- the Comptroller of Public Accounts, or his designee, shall serve as an ex officio voting member.

The Texas Guaranteed Student Loan Corporation is a public nonprofit corporation. A public nonprofit corporation differs from private nonprofit corporations principally in the composition of its board of directors. Private corporations' boards are self-perpetuating: members are nominated and elected to the board by the other members as vacancies occur. Persons eligible for membership and election procedures are usually defined in the private corporation's articles of incorporation. Public nonprofit corporations, on the other hand, are directed by members who are appointed by public officials or elected by the public. In addition, state or local statutes defining the role, scope and duties of the public corporation take the place of articles of incorporation. Examples of public corporations are public agencies such as drainage and irrigation districts, cities, and city housing authorities. At the state level, both the Texas Employers Insurance Association and the Bank Deposit Insurance Corporation were created as public corporations. Using the public corporation structure is a convenient means to carry out a government function while providing for administrative flexibility unavailable to a state agency. The State Bar of Texas and the Hospital Equipment Financing Council are examples of public corporations that are also expressly defined as state agencies in statute.

The board of the TGSLC is the principal means of control the state has over the corporation since the corporation does not come under the legislative appropriations process and is not subject to state statutes governing state agencies and state officials (other than the Open Records Act). The current TGSLC board is made up of 11 members. Eight members are appointed by the governor; one is a member of the Texas Higher Education Coordinating Board, appointed by the chairman of that body; one is a student who is appointed by the Commissioner of Higher Education; and the Comptroller of Public Accounts also sits on the board. Of the eight members

appointed by the governor, the statute states that three must be persons working in commercial finance, three must be members of the faculty or administration of a post-secondary educational institution, and two must be public members who do not derive a majority of their income from either higher education or commercial finance.

The inherent conflicts in the board structure stem from the representation on the board of participating lenders and schools in the guaranteed student loan program. In essence, these persons on the board represent both the insured and the insurer. Lenders who make guaranteed student loans are interested in having any claims they may file for reimbursement on defaulted loans paid to them promptly. Schools are interested in having as many loans as possible available to students to attend their institutions. Both are interested in maximizing the services of the corporation available to their institutions and minimizing any requirements on institutions to participate in the program. The corporation on the other hand, must protect its assets to continue to provide loan guarantees. In doing so, it must set and enforce policies that lenders and schools must adhere to in order to receive reimbursement on claims or to have their students eligible to receive loans. These policies include strict "due diligence" requirements for lenders and student tuition refund policies for schools, for example. The nature of these inherent conflicts as they apply to one type of lender in the guaranteed student loan program is expressly stated in Attorney General Opinion MW-170. That opinion holds that the two offices of board member of a Higher Education Authority and the TGSLC are incompatible because of inconsistent public responsibilities. Higher Education Authorities are so-called secondary markets for guaranteed student loans: they issue revenue bonds for the purpose of buying guaranteed student loans from commercial lenders. The authority, as holder of the guaranteed loans, represents the insured; the TGSLC is the insurer. Although this opinion would not apply to other representatives of commercial finance institutions on the TGSLC board because those representatives do not hold public office, the situations are still similar.

The conflicts that exist in the TGSLC board composition are subtle ones and can't be used for the personal enrichment of any one member or institution. They exist, no doubt, because of the desire to have a balanced representation of all the parties affected by the guaranteed student loan program. Having the expertise of people knowledgeable in commercial finance and higher education helped the corporation to become quickly established and successful. However, even with the present board composition, it is not possible to have a balanced representation of all the parties

affected by the program. There is a wide variation among the types of lenders and schools participating in the program. For example, commercial banks, savings and loans, credit unions, pension funds, higher education authorities, and the Student Loan Marketing Association (Sallie Mae) all make or purchase guaranteed student loans. The type of schools participating include the four year public and private universities, community colleges, vocational and technical institutes, and proprietary trade or vocational schools.

When creating any corporate board structure a choice exists as to whether the interests of each special interest group should be represented, or whether the board should be a public one, dedicated only to the well-being of the corporation. The review found that the policy-making needs of the corporation have shifted from the programmatic knowledge necessary to establish it. The TGSLC is now an established and very large corporation where the principal challenge is careful stewardship of its fiscal assets and integrity. This stewardship can best be provided by a group of public members with proven financial expertise in directing or managing a large organization, but who are not representatives of institutions participating in the program.

Establishing a board without any potential conflicts of interest will ensure that the fiscal integrity of the corporation is the primary concern of the members. While current membership on the board of commercial finance representatives has been invaluable in providing fiscal oversight to the corporation, similar oversight can be achieved through persons from financial institutions not participating in the guaranteed student loan program. There are over 4,000 commercial finance businesses in Texas and approximately 350 actively participate in the guaranteed student loan program. Having the Comptroller of Public Accounts on the board provides valuable fiscal input from a state government perspective and that should continue. However, the statute should specify that the Comptroller may be represented by a person whom he designates. The review found no conflict in having a student serve on the board since all program policies regarding student eligibilities and responsibilities are determined by Congress. The new requirements should apply to new appointments only.

The Advisory Committees Should be Required in Statute

The TGSLC currently has two advisory committees: one of lenders (12 members) and one of school representatives (15 members). These committees appear to serve useful functions, however they are not authorized in statute and there are no formal

corporate rules for them. They were created in 1981 and all members are appointed by the executive director. The purpose of the advisory committees is to advise the TGSLC with regard to program policies, procedures and services as they impact lenders, schools, and borrowers. Formal mechanisms do not exist however, for advisory committee reports to the board of directors.

The TGSLC's school and lender advisory committees should be required in statute and clear statutory directives concerning the corporation's use of advisory committees should be established.

The review found that the use of the current advisory committees is an effective means of obtaining input from those affected by the board's decisions. In addition, the advisory groups are large enough to achieve a balanced representation of the different types of lenders and schools participating in the program. Since they advise the board, however, the committees should be appointed by the board on the recommendation of the executive director.

The advisory committees should be made up of a balanced representation of the different types of lenders and schools participating in the program. A member of the Texas Higher Education Coordinating Board should be a standing member of the lender advisory committee. Requiring the existing advisory committees in statute ensures that this valuable input to the board will continue. Authorizing other committees to be appointed in the future allows the corporation to address future needs and provides a structure for new committees. The statutory language would require the board to specify each advisory committee's purpose, powers, and duties; as well as procedures for issuing reports.

Overall Administration

The evaluation of the administration of the corporation was designed to determine if management policies and procedures, the monitoring of management practices and the reporting requirements of the corporation were consistent with generally accepted practices for the internal management of time, personnel and funds. The corporation's budget and planning processes were reviewed along with the organizational structure established to implement the organization's policies and procedures. Independent audits and management reviews of the corporation, its annual reports, and internal budget documents were reviewed in detail. In addition, the corporation's financial model and its parameters which form the basis for the long term strategic plan of the corporation were examined.

In general, the review found that the corporation is well run and that management problems are identified and resolved effectively. Improvements are needed, however, in areas concerning the accountability of the corporation to the state and the internal accountability of management to the board. In addition, the corporation's investment policies need some adjustments. Finally, a number of changes were identified to increase corporate revenues from sources other than student loan guarantee fees. These changes should ensure that students needing guaranteed loans are charged the lowest fee possible. Recommendations to address these areas are described in the following material.

The State Auditor Should Review the Corporation's Audit

For certain types of operating agencies the legislature has required oversight through an independent audit coupled with an authorization for additional review by the state auditor. The review of the TGSLC determined that while an independent audit was required, the state auditor was not authorized to perform an additional review. Adding this function in the manner described below would complete the oversight requirement.

The corporation's statute regarding fiscal audits by a certified public accountant should be modified to provide that:

- the state auditor shall approve the independent auditor selected by the agency to carry out its annual audit;
- a copy of the annual audit shall be submitted to the state auditor for his review; and
- the state auditor shall have the authority to examine any workpapers from the audit or conduct his own audit if his review of the independent audit indicates this need.

The TGSLC statute requires the corporation to have a fiscal audit performed by a certified public accountant at least once each year. This requirement gives the state auditor no role in this process. Over time the volume of loans guaranteed by the corporation has increased from \$40 million in 1981 to \$378 million in 1987. This increase suggests the need to have strong lines of accountability from the agency to the corporation's board, to the public, and to the legislature.

The TGSLC is not set up as a "typical" state agency; instead, it is a corporation with a statutory authorization in state law. As a result, it does not go through some of the usual state oversight procedures such as the appropriations process or the deposit of its money in the state treasury. A review was made to determine what kind of state audit requirements have been placed on other agencies that also fall outside of some typical state controls.

This review indicated that the state auditor does have specific statutory responsibilities for at least two types of governmental bodies authorized in state law: river authorities and certain metropolitan transit authorities. In the case of river authorities, state statutes require these bodies to submit copies of their independent financial audits to the state auditor annually. The auditor is given the further authority to conduct his own audit if the data submitted to him indicates this need. In the case of the Austin and Houston metropolitan transit authorities, state law requires the state auditor to approve the independent audit firms selected by the agencies for their required financial audits prior to their use. These requirements recognize that, while these governmental bodies are not typical creations of the state, the state has a legitimate concern in ensuring their accountability through limited oversight procedures.

These same provisions should be added to the statute of the Texas Guaranteed Student Loan Corporation. Limited involvement of the state auditor would help improve accountability for an agency whose financial activities have increased significantly since 1981.

The Internal Auditor's Position and Duties Should be Statutory

Recently the executive director of the TGSLC hired the corporation's first internal auditor. This individual reports to the executive director, copies of his reports go to the board's executive committee, and the board has recently requested the auditor to report at each of its meetings. The fact that the corporation has hired

an internal auditor and has positioned him independently within the organization validates management's expressed concern for effective and efficient agency administration. By statutorily requiring this position and specifying the internal auditor's duties, an ongoing check over administrative costs and good management practices is ensured. The review did uncover one concern in the area of administrative costs, however. The corporation does not currently have a good analysis of which of its costs are fixed and which vary according to loan guarantee volumes. Management should develop these cost estimates and the internal auditor should audit the cost accounting system developed. In order to better utilize the corporation's internal auditor and to ensure that current good practices continue, the following changes are recommended.

The corporation's statute should be modified in the following ways to improve the corporation's use of its internal auditor:

- **require the appointment of the internal auditor by the executive director with the concurrence of the board;**
- **require the internal auditor to report to the executive director but authorize the submission of reports directly to the board in situations specified by board rules;**
- **require the board's executive committee to meet with the internal auditor on a regular basis; and**
- **clearly state the duties of the internal auditor to include the examination of the corporation's system of internal controls, as well as its system of identification of fixed and variable costs, including administrative costs.**

Standards developed by the Institute of Internal Auditors state that an internal auditor should report to the person in an organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of reports, and appropriate action on recommendations. According to the standards, there should be direct communication with the board. Also, the independence of the auditor is enhanced when the board concurs in the selection and removal of the internal auditor. Requiring the internal auditor to report to the executive director is consistent with current state policy. A survey last biennium showed that 29 of 34 state agencies with an internal audit department required the internal auditor to report directly to the head of the agency.

A particular area of concern, however, involves the specific duties of the internal auditor. The accounting firm of Coopers and Lybrand recently reviewed the TGSLC's planning capabilities. It was determined that the corporation's financial model was useful for long-term planning; however, it needs to be enhanced if it is to be used to support key policy decisions. In projecting future events, the model fails to completely consider the components of operating costs. Cost assumptions are not broken out by departments or explained in terms of fixed and variable costs. This prevents a clear understanding of how different levels of activity affect costs. Analyzing costs will help the TGSLC plan future operating budgets, identify cost reduction opportunities, and support cost-benefit analyses of capital investment decisions.

Requiring the TGSLC's internal auditor to identify fixed and variable costs, including administrative costs, and to review management's system of control would ensure the efficient and effective use of corporate resources. This approach was affirmed by Executive Order WPC 87-18 issued by Governor Clements on November 12, 1987. It finds that a major objective of internal auditing is to assist members of an organization in the effective discharge of their responsibilities and in identifying potential cost saving opportunities. Also, the standards established by the Institute of Internal Auditors state that the scope of the internal audit should include examining and evaluating the adequacy and effectiveness of the organization's system of internal controls and the quality of performance in carrying out assigned tasks. The primary objectives of internal control are to ensure the reliability and integrity of information; compliance with policies, procedures, laws, and regulations; the safeguarding of assets; the economical and efficient use of resources; and the accomplishment of established goals and objectives.

Increased Efforts Are Needed to Reduce the Guarantee Fee

When a student obtains a Guaranteed Student Loan (GSL) or a Supplemental Loan for Students (SLS) or when a parent obtains a Parent Loan for Undergraduate Students (PLUS), the guarantor charges a fee. The guarantee fee is similar to an insurance premium and is collected by the lender at the time the loan is made. It is deducted from the student's loan and forwarded to the guarantor. The fee generates revenues to help cover defaults and the operating costs of a guaranteed student loan program. A recent change in federal law restricts the fee to three percent or less of the total loan amount. Each guarantor can set its fee within the zero to three percent range.

When establishing the fee, a guarantor considers three things. First, the fee should be high enough to ensure the financial stability of the guarantor. This includes sufficient revenue to support ongoing operating costs, including capital outlays, and sufficient reserves to cover defaults. The second factor to be considered is whether the fee is low enough to be reasonable and fair to the student or his parent. Third, the fee should be competitive. In Texas, the TGSLC has faced competition from the Higher Education Assistance Foundation (HEAF) since 1983. This competition recently intensified when HEAF modified its fee structure and when other state guarantors began expanding their programs outside their own states.

In May 1987, the board of the Texas Guaranteed Student Loan Corporation adopted a guarantee fee of 2.25 percent of the total amount guaranteed for any GSL, SLS, or PLUS loan. This fee applies to any loan application signed by the borrower on or after July 1, 1987. Prior to that time, the guarantee fees averaged 2.5 percent. Increases or decreases in this fee directly affect the cost of the loan for a Texas student or his parent. Exhibit 8 illustrates the effect of increasing guarantee fee rates on the net amount a student would receive on a \$2,000 loan and contrasts that with the net amount to the student if the maximum \$17,250 were borrowed during an undergraduate education. The loan origination fee, set by the federal government, is held constant.

The review examined ways in which the guarantee fee charged by the TGSLC could be lowered in order to provide better service to Texas students. The corporation's budget and methods for controlling and reducing administrative and operating costs were reviewed and found to be adequate. In addition, both management and the board have placed a high priority on reviewing these costs on a continual basis. Because the nature of the TGSLC's business is so dynamic and heavily influenced by both federal government requirements and constraints and competition from other guarantors, however, it is not advisable to specify a guarantee fee in statute. The review determined that the best way to ensure guarantee fees are held to a minimum is to incorporate this policy into the statute and to increase revenues from other sources to the corporation. The guarantee fee currently represents the corporation's largest single source of income. In fiscal year 1987, the fees amounted to \$9.5 million and represented 58 percent of the corporation's revenue for the year. The corporation's other sources of income currently include the federal administrative cost allowance, loan servicing fees, investments, and recoveries on defaulted loans. The corporation's share of recoveries

Exhibit 8
Effect of Guarantee Fee Rates on Net Loan Amount

Loan Principal Amount: \$2,000			Loan Principal Amount \$17,250			
Guarantee Fee		Origination Fee at 5%	Net Amount to Student	Guarantee Fee Amount	Origination Fee at 5%	Net Amount to Student
Rate	Amount					
0.00%	\$0	\$100	\$1,900	\$0	\$863	\$16,388
0.25%	\$5	\$100	\$1,895	\$43	\$863	\$16,344
0.50%	\$10	\$100	\$1,890	\$86	\$863	\$16,301
0.75%	\$15	\$100	\$1,885	\$129	\$863	\$16,258
1.00%	\$20	\$100	\$1,880	\$173	\$863	\$16,215
1.25%	\$25	\$100	\$1,875	\$216	\$863	\$16,172
1.50%	\$30	\$100	\$1,870	\$259	\$863	\$16,129
1.75%	\$35	\$100	\$1,865	\$302	\$863	\$16,086
2.00%	\$40	\$100	\$1,860	\$345	\$863	\$16,043
2.25%	\$45	\$100	\$1,855	\$388	\$863	\$15,999
2.50%	\$50	\$100	\$1,850	\$431	\$863	\$15,956
2.75%	\$55	\$100	\$1,845	\$474	\$863	\$15,913
3.00%	\$60	\$100	\$1,840	\$518	\$863	\$15,870

of loan defaults are examined in the program evaluation section of this report. The corporation currently qualifies for the maximum possible federal administrative cost allowance and is aggressively promoting its loan servicing. Revenues from loan servicing are currently growing at more than 400 percent a year. However, the

The statute should direct, as a matter of policy, that the board is to charge the lowest guarantee fee possible under federal requirements which will not endanger the fiscal viability of the corporation.

review found that earnings on investments could be improved. Three recommendations are set out below which will provide a policy framework regarding the guarantee fee and require the corporation to improve its investment practices

and develop alternative revenue producing services to ensure the fee remains as low as possible.

The need for a low fee in Texas is amplified by the competitive nature of the guarantor market. As mentioned above, HEAF -- one of the private national guarantors -- has announced its intent to not charge a fee to students attending four-year schools and to charge 1.5 percent to students attending two-year community colleges and non-profit trade and technical schools. However, students attending proprietary schools will be charged three percent. If this attracted more Texas students in four-year programs to HEAF, the results could be damaging to the TGSLC. For example, a recent Coopers and Lybrand study stated that if the mix of student loans guaranteed by the TGSLC were weighted more heavily to proprietary schools rather than four-year schools (50 percent versus 30 percent), the corporation's cash flow would decline by approximately \$5 million. In addition, the rate of default would probably increase since students in proprietary schools historically have a higher default rate than those in four-year colleges. The TGSLC is a non-profit entity and should enhance the availability of higher education opportunities by providing students with the lowest possible fee that protects the long term viability of the corporation. Putting this policy into the statute will help ensure that minimizing the guarantee fee remains a top priority of the corporation.

The board should evaluate the corporation's investment policy and make changes as needed. The evaluation should address:

- **the development of a plan to dispose of IBM and Exxon shares;**
- **the benefits of authorizing longer term investments; and**
- **the benefits of investing guarantee account funds with the Texas Treasury Safekeeping Trust Company.**

The corporation is statutorily authorized to invest its money in direct obligations of the United States, general obligations of the United States, obligations backed by the full faith and credit of the United States, and obligations guaranteed by the United States. The corporation's current investment portfolio, detailed in Exhibit 9, includes federally-backed agency securities, government security mutual funds, treasury instruments, certificates of deposit (CDs), and equities. Concerns about the corporation's authority to hold stock and the corporation's return on investments were identified during the review. The corporation does have a written

investment policy approved by the board. This policy is reviewed annually but was last revised in 1984. It needs to be re-evaluated to assess the items noted above. Regarding the corporation's equities, or shares of Exxon and IBM stock, the corporation is not authorized in statute to hold this type of investment instrument. The corporation received these shares in 1981 from United Student Aid Funds, Inc. (USAF). USAF was established under the federal Higher Education Act of 1965 to guarantee student loans in those states, such as Texas, which did not have a regional guarantee agency. After the TGSLC was established, it entered into an agreement to transfer the Texas federal advance fund from USAF to the corporation. The transfer included \$137,303 in cash and marketable securities. The Exxon and IBM stock has been held by the corporation since that time. Since the corporation is not authorized to hold stock, a plan is needed to dispose of the stock when it can be done without incurring a loss and should be incorporated into the TGSLC's investment policy.

Exhibit 9
TGSLC INVESTMENT PORTFOLIO
(beginning of FY 1987)

	<u>Amount Invested</u>	<u>Percent of Portfolio</u>
Certificates of Deposit	\$ 1,097,500	7%
Government Security Trust Funds	4,235,603	26%
Agencies	8,107,379	50%
Treasuries	2,656,840	16%
Equities	69,706	0%
TOTAL PORTFOLIO	\$16,167,028	100%

- Agencies = Federally backed securities such as Fannie Mae, the Federal Home Loan Bank, etc.
- Treasuries = Actual treasury instruments (bills, notes, and bonds)
- Government Security Trust Funds = Merrill Lynch (3 year average maturity)
Prudential Bache (5 year average maturity)
- Equities = 2,000 shares of Exxon, 350 of IBM

The second concern regarding the corporation's investment practices relates to the short-term orientation of its investment policy. The investment policy calls for maximum time period of investments of three to five years. The corporation's funds are invested with maturity dates much less than five years in the majority of cases. In fact, the weighted average maturity for the corporation's total portfolio was just

over two and a half years as of the end of fiscal year 1987. Longer maturity periods can yield higher rates, but have to be balanced against the short term cash needs of the corporation. It was necessary for the corporation to adopt a short term strategy when it was new and its cash requirements and timing could not be easily determined. Now that the corporation has matured and has a more established pattern for its business, however, it should consider more long term investments in order to increase investment returns.

The third concern regarding the corporation's investments relates to the effective yield on those investments. The TGSLC board recently considered retaining an outside investment advisor to oversee the corporation's investments but rejected the idea in part because the size of the portfolio and the statutory restrictions over the types of investments mean that the yield would not increase enough to justify the extra expense. The TGSLC estimated that the annual fees to manage the portfolio would be between \$40,000 and \$85,000. The review identified an alternative, however, that could benefit the corporation and which it should seriously consider.

The 69th Legislature authorized the state treasurer to serve as a trustee of funds held outside the treasury. In addition, it established the Texas Treasury Safekeeping Trust Company (Sec. 404.102, Texas Government Code). The trust company has as its purpose to provide a means for the treasurer to obtain direct access to services provided by the Federal Reserve System to enable the treasurer to manage and invest public funds and securities more efficiently and economically. Funds held by the trust company are entirely separate from other funds in the treasury. Through the trust company, the state treasury has direct access to the federal reserve system, including access to fund transfers by wire. Several agencies, including the Texas Housing Agency, the Department of Banking, and the Texas Public Finance Authority, have recently taken advantage of the opportunity to have their funds managed by the Texas Treasury Safekeeping Trust Company.

A potential problem for the corporation in placing its funds under the trusteeship of the State Treasury would stem from any reduced access of the corporation to the funds when they are needed to meet lender claims. This problem can be avoided through the development of a funds management agreement between the corporation and the treasury. This agreement, common in the treasurer's dealings with other agencies outside the treasury, would specify how money would be transferred to allow the corporation appropriate access to funds needed to pay

lenders for defaults. Any funds management agreement with the State Treasury should be incorporated as part of the corporation's revised investment policy.

The wise investment of the guarantee account funds is critical to the financial stability of the guaranteed student loan program. The return on those investments affects the corporation's ability to pay lenders for defaulted loans and has an impact on the amount of the guarantee fee charged to students and parents. Improving the rate of return ensures the TGSLC's ability to pay for defaults and could result in a lower fee. Therefore, the expertise available through the State Treasury should be considered for this endeavor.

The statute should authorize the TGSLC to do need analysis for student financial aid and to become a Multiple Data Entry (MDE) processor used in determining Pell Grant awards. It should also authorize TGSLC to service other states' guaranteed student loans. Prior to engaging in these activities, the board must find that the revenues collected will be enough to cover costs and reduce students' guarantee fees.

In addition to revising its investment policy, the TGSLC should have the statutory authority necessary to keep students' guarantee fees to a minimum. The agency's statute was examined to determine whether it should clearly authorize additional activities that could help keep students' loan fees low. The analysis identified three additional services that the statute should clearly authorize and that the TGSLC should consider providing. These services will provide additional revenues for the TGSLC.

First, the statute should authorize the corporation to determine a student's need for financial aid. To be eligible for federal financial aid, as well as many other types of aid, the student's and his or her family's ability to pay for the educational expenses must be analyzed. Need analysis organizations use well established but complex formulas to determine financial need. These organizations contract with school financial aid offices to facilitate the collection and processing of the data and the reporting of the results.

Second, the TGSLC should be authorized to become a MDE Pell Grant processor. The Department of Education (DOE) contracts with MDE processors to determine the amount of Pell Grant money for which a needy student is eligible. MDE processors are limited in number by federal statute and must be approved by the DOE. Before approval is granted, the MDE processor must pass quality control

tests to prove that the Pell Grant formulas are calculated in accordance with federal regulations. Federal law was recently changed to require the Department of Education to contract with at least five multiple data entry processors. There are currently four MDE processors: The Illinois State Scholarship Commission (ISSC), the Pennsylvania Higher Education Assistance Authority (PHEAA), the American College Testing (ACT) service, and the College Scholarship Service (CSS). The open slot will be filled through a request for proposal process. Authorizing the TGSLC to apply to become a MDE processor could benefit the corporation if it is selected since the DOE pays the processor a fee based on the cost of processing each application. The ISSC's fee is the lowest at less than \$1 per application while ACT and CSS charge the department around \$4 per application.

Third, a potential source of revenue is contracts with other states to provide them with services related to guaranteed student loans. The services could take a variety of forms. For example, because of the high volume of loans in Texas, the TGSLC can print its application much cheaper than surrounding states can. If the TGSLC and another state could agree on a common application, the corporation could print it and sell it to that state. This has been done in Oregon and Washington where the guarantee agencies developed a joint application. Because of the higher volume, their printing costs have been reduced. Another example of a service the corporation could offer would be to contract with another state to actually process a student's or parent's application. This process is computerized and the TGSLC's computer currently has the capacity to perform additional processing. Under any of these contracting for service scenarios, the other state would continue to serve as the guarantor. Since the TGSLC's guarantee account can only be used to pay claims on defaulted loans it has guaranteed, there would be no risk to the guarantee account.

Authorizing the corporation to be a MDE processor and a servicer of other states' guaranteed student loans gives the corporation clear authority to analyze these options and pursue them if appropriate. However, to ensure that each option has been carefully weighed, the board should also be required in statute to examine the cost-benefit of any new activity. The new service should both cover costs and provide sufficient revenues to lower student guarantee fees to be worthwhile.

Evaluation of Programs

The Texas Guaranteed Student Loan Corporation administers one basic program: the guaranteed student loan program (GSLP). This is a federal program for which the TGSLC is the administering, or guarantee agency for Texas. the program is made up of three components:

- the Texas Guaranteed Student Loan Program (TGSL);
- Texas Supplemental Loans for Students (TSLS); and
- the Texas Parent Loan Program (TPLUS).

The review focused on whether or not the corporation had successfully implemented the guaranteed student loan program and whether it had significantly increased the loan capital available to Texas students for higher education. In addition, it examined whether the guaranteed loans are available to all eligible students, whether the procedures for students and lenders are clearly defined and implemented, how quickly loan applications are processed, and how responsive the corporation is to the students, lenders and schools it deals with in the program. Two lender operations were visited, one higher education authority, and two university financial aid offices in order to see first hand how the program works. In addition, financial aid officers from a variety of school types (public and private university, community college, vocational school) were interviewed by telephone.

The review found that the TGSLC has been very successful in accomplishing its goal: making available low interest loans to students by guaranteeing the loans and providing services to lenders. In fact, the program has been so successful that today any eligible student can get a guaranteed student loan in Texas. Information on the program is widely available and the lenders that participate are located in all areas of the state, some will even accept loan applications by mail. In addition, the review found nearly unanimous support of the corporation and its staff by lenders and schools participating in the program for the attention, service, and quick processing of guarantees. The major problem with the program, however, is the increasing number of loan defaults. This is a national problem and one that receives much attention. Recommendations to address the TGSLC's handling of loan defaults are set out below.

Controlling Loan Defaults

Approximately half the federal guaranteed student loan program budget or \$1.6 billion per year goes to defaults; in Texas approximately \$115 million or 13.5 percent of matured loans are in default. The TGSLC is reinsured (reimbursed) by

the federal government for default claims it pays to lenders at 100 percent, so long as its default rate remains under a five percent trigger. The reinsurance drops to 90 percent, and then 80 percent as the default rate on claims increases above five percent and above nine percent, respectively. The reimbursement percentage is not retroactive and the calculation starts over again at the beginning of each federal fiscal year. The TGSLC is currently reimbursed for approximately 96 percent of claims it pays to lenders. The corporation pays for un-reinsured claims through the guarantee fund account which is funded in part through insurance fees charged each student obtaining a loan. As defaults go up, pressure on the corporation to increase insurance fees also increases. However, there is a maximum fee limit of three percent (TGSLC currently charges 2.25 percent).

The review focused on areas that can be addressed by the Texas statutes and the TGSLC to reduce or prevent student loan defaults and their costs to the corporation. The TGSLC's existing statutory authority regarding defaults and collection authority was examined and compared to authority granted to guarantee agencies in other states. In addition, the corporation's policies for lender and school participation in the program were examined as well as procedures for ensuring student loan eligibility under federal requirements. The TGSLC's preclaims, claims, and collections department's procedures and reports were carefully reviewed as this is the department primarily responsible for both approving lender default claims and pursuing defaulted borrowers.

The review found that controlling defaults is a primary concern of the corporation. For example, the preclaims, claims and collections department uses state-of-the-art technology to assist lenders in preventing defaults and to locate and pursue defaulted borrowers. The corporation also pursues defaulted borrowers with legal action when necessary and makes use of all other collection authority currently granted to it. The review found, however, that additional efforts could be made to reduce defaults at the state level. First of all, the corporation's policies and procedures regarding school and lender participation in the program need to be modified and enforced more strictly. Statutory modifications of the corporation's authority regarding collections from individuals in default are also needed as well as involving the cooperation of Texas professional and occupational regulatory agencies in dealing with student loan defaulters. Finally, the corporation should formally consider retaining one or more private collections agencies to supplement the efforts of its in-house collections department. Recommendations to address these findings are described in the following material.

Schools' Awareness of Responsibility for Defaults Should be Increased

Under the GSLP the guarantee agencies, the federal government, and students receiving loans currently carry all the financial burden for defaults. Schools in the program are responsible for certifying the eligibility of a student for a guaranteed student loan. Eligibility criteria include at least half-time enrollment, financial need, etc. They must also provide information on student loan obligations and other forms of financial aid available. Schools currently bear no responsibility for the loan defaults of students. However, there are steps that schools can take to reduce to some extent the defaults of their students.

The corporation should be required by statute to notify all schools of their default rates at least twice a year.

The TGSLC is authorized under federal regulations to notify schools of their default rates and is required to respond to any requests for this information. The TGSLC however, operating under the philosophy that "schools don't default--students do," has chosen to simply answer requests for default information from schools. There were seven such inquiries during three months in the summer of 1987. In a related program, the Texas Higher Education Coordinating Board administers the state's Hinson-Hazelwood College Student Loan Program. Under this program schools are notified monthly of the loan repayment status of their former students. Coordinating Board officials report that this information makes schools aware of any problems and helps them to cooperate in finding defaulted borrowers. Informing schools at least twice a year would coincide with the semester scheduling of many universities and not be too burdensome to the corporation.

The corporation's statute should clearly indicate that default rates higher than 20 percent (as currently defined for schools by TGSLC) may be grounds for limitation, suspension, or termination from the program.

The Secretary of Education, William Bennett, has recently announced new departmental policies for the GSLP whereby schools which do not reduce their default rate to 20 per cent by 1990 will be cut off from all future federal financial aid. The overall "gross" default rate on loans guaranteed by the TGSLC at Texas schools

is 12.7 percent, but 137 schools (out of 426) have default rates above 20 percent. The TGSLC is granted "limitation, suspension, and termination authority" under the federal regulations to eliminate schools or lenders from the program it finds out of compliance. The TGSLC board has adopted a policy however that a high default rate for a given school in and of itself is not grounds for suspension or elimination from the program. The corporation's policy manual states: "While the default rate of a school shall not, by itself, be grounds for the limitation, suspension, or termination of a school's eligibility to participate, it shall be considered as one measure of the school's overall financial aid administration."

Research into the default problem has shown that student characteristics such as ethnicity, having a low family income, not completing the program, and being a high school drop out are the strongest predictors of whether a student will default. In fact, the TGSLC default figures bear this out to the extent that the vast majority of the high-default schools are vocational and technical or proprietary schools that historically have higher numbers of disadvantaged students enrolled. However, school administrative practices do have some influence on the default rate. The Secretary of Education in announcing the new federal policies to hold schools accountable for default rates outlined several steps that schools can take to help reduce their rate. These include admitting only those students who can actually benefit from their program; adopting less punitive refund policies; providing better debt counseling and consumer information to students; sharing information on defaults with lenders and guarantee agencies; and taking steps to improve the outcomes of their programs for students.

Since the default problem is of such great importance to the integrity of the guaranteed student loan program, the accreditation of schools which forms the basis of a school's eligibility to participate in the program is an important concern. In Texas, the Texas Education Agency (TEA) is the agency responsible for accrediting vocational educational schools. Since the TEA is also scheduled for sunset review later this cycle, that agency's accreditation of vocational schools as it affects the guaranteed student loan program will be reviewed at that time.

Informing schools of their default rates on Texas guaranteed student loans helps them to become aware of the problem. In addition, changing the current TGSLC policy regarding grounds for limitation or termination from the program sends schools the message that they are expected to take whatever actions possible to reduce defaults among students. The 20 percent cutoff will also bring TGSLC policy in line with new federal regulations and recognizes that certain types of institutions

will have default rates higher than the 13 percent average program-wide because of the make up of their student body.

Increased Lender Responsibility for Defaults is Needed

Lenders in the GSLP must comply with "due diligence" standards in making and trying to collect on loans. However, as long as these are followed, lenders are reimbursed for 100 percent of all defaults. The TGSLC policy manual states that a lender's default rate shall generally be less than 15 percent of the loans it makes. The review found that the corporation is not currently enforcing this policy, with the result that a small minority of lenders account for a disproportionate share of loan defaults.

The corporation's statute should clearly indicate that default rates higher than 15 percent may be grounds for limitation, suspension, or termination from the program.

A lender may deny a loan to a student because of poor credit risk, but there are many "open door" lenders today who will make a guaranteed student loan to any eligible student. There is discussion at the federal level to reduce the guarantee to lenders to 90 percent to make them more responsible for defaults. The review of the TGSLC examined the default rates of current lenders participating in the program. Current lenders are the ones who currently own the guaranteed student loan paper and thus represent those who would file a claim with the TGSLC should a loan default. Approximately 40 percent of the participating lenders who make the original loans to students ultimately sell those loans to secondary markets before the loan enters repayment.

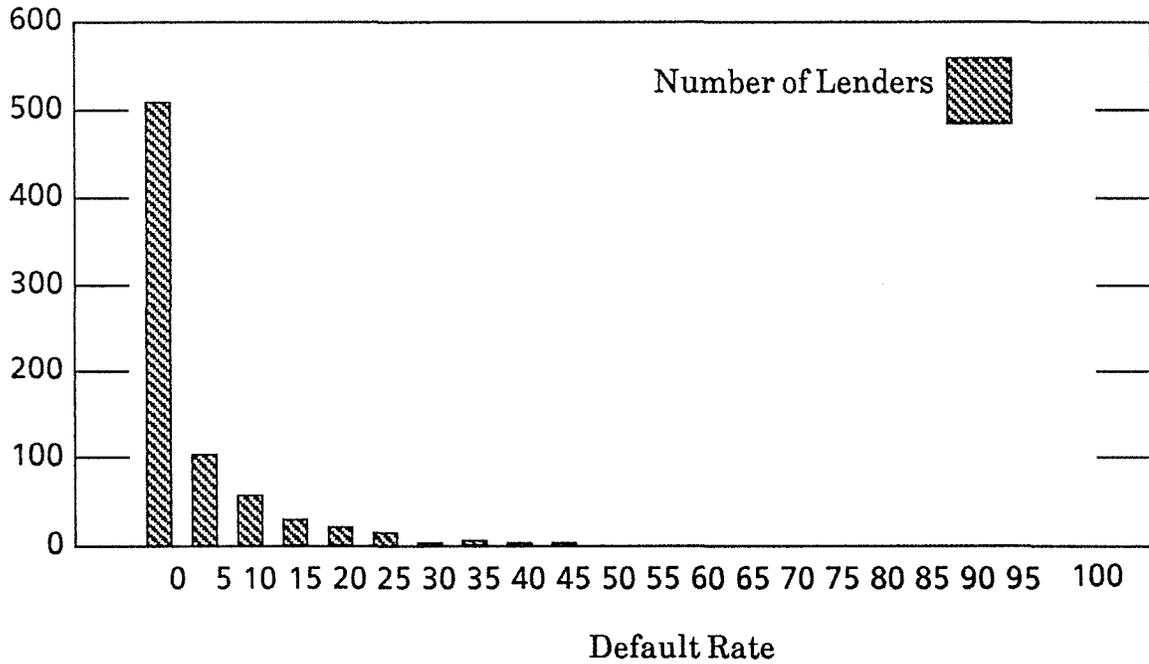
The review found that 90 percent of the current lenders in Texas had default rates well under 15 percent (see Exhibit 10). The remaining ten percent of the current lenders, however, had default rates ranging as high as 100 percent. Since these ten percent account for approximately 19 percent of the dollar amount of matured loans, the overall default rate of the TGSLC portfolio is approximately 13.5 percent. Closer examination of the lenders with high default rates suggested that these lenders generally have either a small amount of matured loans; are located in an economically depressed area; or are no longer active in the program. If the lender has a very small number of matured loans, defaults on only a few will yield a high default rate. Banks in economically depressed areas, or that have actually become

Exhibit 10

**TGSLC Current Lenders Default Percentages
(Texas only)**

<u>Percent of Loans in Default</u>	<u># of Lenders</u>	<u>% of Lenders</u>
Less than or equal to 0	510	65%
More than 0, less than or equal to 5%	104	13%
More than 5, less than or equal to 10%	59	8%
More than 10, less than or equal to 15%	31	4%
More than 15%	75	10%
Total Texas Lenders	779	100%

Number of Lenders



insolvent, are either not spending as much staff time and effort in preventing the loan defaults or simply cannot collect due to the economic difficulties of the debtors. In addition, if a lender is no longer participating in the program, the "good" loans either mature and get paid off or can be sold while the lender is left holding the "bad" loans. These factors work together to increase the default percentage for lenders no longer active in the program.

As stated earlier in this report, the guarantee agencies, the federal government, and the students receiving the loans currently carry all the financial burden for loan defaults. The lenders are basically reimbursed for 100 percent of the principal and accrued interest when a loan defaults -- as long as they practice "due diligence" in trying to collect the loans before filing a claim. The review showed that a small minority of lenders are responsible for high default rates. The TGSLC has a policy that lenders shall "generally" not have a default rate in excess of 15 percent. This policy has never been enforced and does not define what exceptions will be granted. Since this is one area where the corporation can directly limit the amount of default claims it has to pay, the TGSLC should start to enforce this policy. Putting the policy into statute helps to ensure that enforcement of the policy is an ongoing concern of the corporation. In addition, authorizing but not requiring the corporation to base program eligibility on the default rate allows the corporation the flexibility to make exceptions when warranted.

The 15 percent default rate is used in this recommendation, as opposed to the 20 percent cutoff in the previous recommendation concerning school defaults, because a lender's rate should be much closer to the average portfolio default rate since a lender need not concentrate his portfolio in high risk schools. Since a lender has more direct control over the degree of his portfolio risk -- both in terms of to whom a student loan is given and his authority to pursue collections and grant deferrals -- the lender should be held to a higher standard than schools as far as allowable defaults. Similarly, the higher allowable school default rate recognizes the fact that large universities have historically very small default rates and smaller vocational schools have much higher rates. In addition, the federal Department of Education has chosen to use a 20 percent cutoff rate for schools vis a vis defaults and the TGSLC's current policy for lender participation requires default rates less than 15 percent.

Actions Should be Taken to Increase Sanctions for Defaulted Borrowers

The TGSLC was created by the Texas legislature with the expectation that it pay all its expenses from income it receives and that it not receive ongoing legislative appropriations. Collections on defaulted loans (for which TGSLC has already reimbursed the lender) are called recoveries and represent a significant source of income to the TGSLC. The federal government allows the corporation to retain 30 per cent of all recoveries on claims. A recent study by the United States Government Accounting Office examined guarantee agencies' collection practices and procedures. Among the collection techniques other state guarantors reported to be the most successful are state income tax refund offsets and wage garnishments. In addition, the federal government regularly checks its payroll against lists of defaulted borrowers and works out a deduction for employees found in default. Since Texas does not have a state income tax, the wage offset authority is the main effective collection tool available to the TGSLC.

The TGSLC loan application/promissory note should contain a valid wage garnishment waiver agreement for state employment.

The Texas statute gives the TGSLC special authority to help it collect on defaulted student loans. For example, the TGSLC can bring suit in Travis county against all defaulting parties and may use private counsel. In addition, the Comptroller of Public Accounts is instructed to not issue warrants to persons the TGSLC has identified as being in default on a guaranteed student loan. The TGSLC has experienced problems, however, in exercising its authority regarding Comptroller warrant holds. In a memo dated January, 1986, Attorney General Jim Mattox notified the Comptroller that the withholding of a warrant for current wages upon default on a student loan is an unconstitutional garnishment of wages prohibited by Article XVI, Section 28 of the Texas Constitution. Consequently, only warrants for travel, vendor payments, and tax reimbursements to persons in default on a student loan are currently held. However, the memo states that warrants for state salary payments could be held if the employee waives the protection afforded by the Constitution by signing a valid waiver agreement. For a waiver agreement to be valid it should be an entirely voluntary action on the part of the person signing it. It is questionable that a person can truly voluntarily waive his constitutional

protection from garnishment at the time he accepts employment. Signing such a waiver when a person is applying for a student loan is much more voluntary, however, because that person is not in need of employment at that time. The Texas Higher Education Coordinating Board, working with the Attorney General's office, has recently incorporated a valid waiver clause into one of its loan application forms. The TGSLC should incorporate a similar clause into its loan application forms.

Limiting the waiver to apply to state employment appears reasonable for at least two reasons. First of all, the state has direct control over the paychecks it issues and state employment is where the enforcement of the recommendation will occur. In addition, broadening the scope of employment sanctioned beyond state employment could be interpreted by the court as true wage garnishment and prohibited under the constitution.

The corporation's statute regarding comptroller warrant holds should be amended by adding the qualifier "unless failure to issue the warrant would violate the Texas Constitution."

The TGSLC loan application form needs to contain a valid waiver clause to allow the corporation to legally exercise the authority already granted to it. In addition, the statute should be amended to reflect the current constitutional prohibition to wage garnishment, yet allow the provision to be enforced should the constitution ever be amended.

Use of State Professional Licensing Agencies Could Lower Default Rates

In addition to special collection authority, the TGSLC statute requires each state agency and political subdivision to cooperate with the corporation. The statutory language does not specify ways in which agencies are to cooperate and the language is only in the TGSLC statute. To date there has been only limited inter-agency cooperation with the TGSLC. For example, the Texas Department of Public Safety notifies the TGSLC of all address changes when a person renews a drivers' license. This helps TGSLC to locate some defaulted borrowers. The review determined that statutorily requiring cooperation of other state agencies, specifically professional licensing agencies, with the TGSLC could increase the sanctions available for defaulted student loan borrowers and discourage future defaults. The essential steps to gain the assistance of the licensing agencies are set out below.

State professional and occupational licensing statutes should be modified to:

- **establish that defaulting on a guaranteed student loan is a ground for not issuing or renewing the license;**
- **require licensing agencies to collect and submit to the TGSLC licensee or applicant information (full name, social security number, date of birth, etc.) needed to match TGSLC borrower data; and**
- **require licensing agencies to cooperate with the TGSLC and take actions to deny or revoke licensure for those persons in default on guaranteed student loans.**

Many persons use guaranteed student loans to get an education to enter an occupation or profession which is regulated by the state. Most state professional and occupational licensing statutes make reference to the moral character or fitness of a candidate for licensing. However, none of the statutes specifically prohibit the issuance or renewal of a professional or occupational license on the grounds of defaulting on a student loan. Unlike commercial loans, guaranteed student loans are supported by government funds. Were it not for the government guarantee and interest subsidies on these loans, lenders would not be making them. Without the loans, millions of students could not afford a higher education. Yet the loan program's continued existence could be in jeopardy if the defaults in the program are not controlled. In addition, a review of the schools with the highest default rates shows that the majority are vocational or technical schools which prepare persons for careers subject to state licensure. Barber and Cosmetology schools are perhaps the worst examples of these, with defaults at some ranging as high as 100 percent.

Prohibiting the issuance of a professional license to persons in default on guaranteed student loans would provide a powerful incentive for a person to stay current on his loan payments. The review identified two states that are moving in this direction. The State Bars of both Georgia and Florida currently investigate the student loan status of applicants to the bar as part of the overall moral fitness investigation. Applicants who are found to be in default on a guaranteed student loan and who refuse to rectify their situations are not certified to take the bar exam.

Through discussions with several state licensing agency officials and representatives of the comptroller's office, the review identified a general framework

that needs to be in place for a state policy of not issuing or renewing professional or occupational licenses on the grounds of defaulted student loans. First of all, each of the regulatory statutes involved needs to be amended to specifically make default a ground for not issuing or renewing the license. Exhibit 11 lists the licensing entities identified during the review that should be included. Secondly, a basic procedure should be outlined in statute to define the responsibilities of the parties involved yet allow for enough flexibility so that the costs of implementing the policy don't outweigh the anticipated benefits. In addition, it is important that the process of checking for defaulted student loans doesn't penalize the vast majority of honest persons nor lengthen the licensing process for the individual applicants. To best accomplish this, the review determined that each individual licensing agency should amend its application forms to inform applicants of the new law and to ask applicants directly about their student loan history. The agencies would be responsible for collecting the proper information and sharing it with the TGSLC (the majority of the large licensing agencies have their process automated so difficulties with producing the information are minimized). Each agency would not have to determine the loan status of applicants prior to issuing the license, but would, however, deny licensure to anyone who indicated on the application that he was in default. The TGSLC would be responsible for the actual checking of information gathered and determining if any of the persons identified had a defaulted student loan. If so, the TGSLC would use the information to locate the defaulted borrower and proceed with its normal collections procedure. The TGSLC would now have an additional threat over the defaulted borrower, however, that the person is in violation of his professional licensure. In the probably rare case where that threat did not induce the defaulted borrower to begin repayments on the loan, the TGSLC would go to the licensing agency and request that it proceed to revoke or refuse to issue the license. Although for purposes of administration the license can be most easily revoked on the grounds of falsification of an application, the statutes should also be amended to make the default in and of itself grounds for not being licensed. In this way, applicants can be initially screened by having to attest to their student loan status and defaults that might occur after licensure can be prevented because of the ongoing licensing requirements.

In order to establish the data links between the TGSLC and the agencies, the review determined that the statute should provide some flexibility. The statute should state that the corporation and the agencies will share data on the agencies' licensees in a manner that is mutually agreeable. This approach allows for a

Exhibit 11

Professional and Occupational Licensing Agencies

<u>Agency</u>	<u>Profession or Occupation Regulated</u>	<u>Number of Licensees 1986</u>
Texas Real Estate Commission	Real estate brokers and salespeople	177,727
Texas Cosmetology Commission	Hairdressers, cosmetologists, beauty instructors	135,244
Board of Nurse Examiners	Registered Nurses	109,494
Texas Board of Private Investigators and Private Security Agencies	Private investigators and agencies, alarm system installers, commissioned security officers	79,099
Securities Board	Persons dealing in securities	72,951
Board of Vocational Nurse Examiners	Vocational nurses	71,221
State Bar of Texas	Attorneys	50,000
State Board of Registration for Professional Engineers	Professional engineers	44,871
Texas State Board of Medical Examiners	Medical doctors and Doctors of Osteopathy	40,808
Texas State Board of Public Accountancy	Certified Public Accountants	37,225
Texas State Board of Plumbing Examiners	Plumbers and plumbing inspectors	22,850
State Board of Barber Examiners	Barbers and barber instructors	22,426
Texas State Board of Dental Examiners	Dentists and dental hygienists	17,761
Commission of Fire Protection Personnel Standards and Education	Fire protection personnel, crash and rescue firefighters	17,000
Texas State Board of Pharmacy	Pharmacists	14,902
Texas Board of Architectural Examiners	Architects and landscape architects	10,051
Council for Social Work Certification	Social workers	8,655
Structural Pest Control Board	Persons involved in structural pest control	8,157
Texas State Board of Examiners of Professional Counselors	Professional counselors	7,934

<u>Profession or Number of Agency</u>	<u>Occupation Regulated</u>	<u>Licensees 1986</u>
Texas State Board of Examiners of Psychologists	Psychology associates, specialists and psychologists	5,177
Texas Funeral Service Commission	Embalmers and funeral directors	4,742
Texas State Board of Veterinary Medical Examiners	Veterinarians	4,437
Texas Department of Health	Speech pathologists and audiologists	4,337
Board of Tax Professional Examiners	Appraisers, assessor/collectors,	4,038
Texas Department of Health	Medication aides	3,727
Texas Board of Land Surveying	State land and public surveyors	3,543
Air Conditioning and Refrigeration Contractors Advisory Board	Air conditioning and heating contractors	3,380
Texas Board of Physical Therapy Examiners	Physical therapists	3,329
Texas Board of Licensure for Nursing Home Administrators	Nursing home administrators	2,635
Texas State Board of Examiners of Dieticians	Dieticians	2,552
Board of Irrigators	Irrigators and installers	2,546
Texas Optometry Board	Optometrists	2,071
Texas Advisory Board of Occupational Therapy Examiners	Occupational therapists	2,062
Texas Board of Chiropractic Examiners	Chiropractors	1,554
Texas Water Well Drillers Board	Water well drillers	1,383
Texas Department of Health	Massage therapists	1,188
Texas Department of Health	Respiratory therapists	946
Texas Board of Examiners in the Fitting and Dispensing of Hearing Aids	Persons who fit and dispense hearing aids	728
Texas State Board of Podiatry Examiners	Podiatrists	692

<u>Agency</u>	<u>Profession or Occupation Regulated</u>	<u>Number of Licensees 1986</u>
Polygraph Examiners Board	Polygraph examiners	636
Court Reporters Certification Board	Court reporters	627
Texas Department of Health	Athletic Trainers	599
Texas Commission for the Deaf	Interpreters for the deaf	223
TOTAL		1,005,528

common sense approach to be used due to the varying size and data automation capabilities of the many licensing agencies. In addition, all the costs of checking the information to find the defaulted borrowers are the responsibility of the TGSLC, which is the party that benefits most directly. It would be the TGSLC's responsibility to request the state agency's assistance for denying or revoking a license.

The TGSLC Should Evaluate the Benefits of Using Private Collection Agencies

Once the TGSLC pays a claim to a lender for a defaulted student loan, the TGSLC "owns" that loan. The TGSLC, after filing for federal insurance, continues to try and collect the loan from the borrower until "he dies or is permanently disabled." Federal regulations prohibit the TGSLC from writing off any loans and the TGSLC is allowed to keep 30 percent of any amounts it eventually recovers defaulted loans. The 53 TGSLC employees in the preclaims, claims and collections department currently handle all the corporation's collections activities. In addition, accounts are referred to a private attorney the TGSLC contracts with for filing suits but does not use a private collection agency to assist in debt collections.

The TGSLC should evaluate the costs and benefits of using private collections agencies to assist in collecting on defaulted student loans.

In fiscal year 1987, the TGSLC recovered approximately \$4.25 million, but there are still approximately \$115 million in defaulted student loans outstanding. The TGSLC states that its current rate of converting 32 percent of active claims to either repayment or paid in full status is among the best rates of guarantee agencies nationally. However, a recent United States General Accounting Office (GAO) report on guarantee agencies' collection practices and procedures lists the most successful collection techniques used by guarantee agencies. The TGSLC is currently employing all the successful techniques listed except for state income tax refund offsets (not applicable in Texas), full wage garnishments (illegal under the Texas constitution), and the use of collection contractors. While 74 percent of guarantee agencies have in-house collection units, like the TGSLC, almost all of these supplement their efforts by using private collection contractors. According to the GAO report, the guarantee agencies employ an average of five collection

contractors. The TGSLC has never formally considered or studied the use of private collection contractors and could be overlooking a potentially useful collection technique.

Loan defaults are the biggest problem facing the guaranteed student loan program. The corporation must do everything in its power to reduce the amounts of defaulted loans. Collections staff are significant in controlling defaults and their costs should be carefully analyzed. Alternatives that might yield higher benefits at the same or reduced costs should be thoroughly explored. Many guarantee agencies in other states use private collections agencies to assist their efforts in recovering defaulted loans. The TGSLC should study this alternative to see if it might produce results in Texas.

OTHER CHANGES

Minor Modifications of Agency's Statute

Discussions with agency personnel concerning the agency and its statute indicated a need to make minor statutory changes. The changes are non-substantive in nature and are made to comply with federal requirements or to remove out-dated references. The following material provides a description of the needed changes and the rationale for each.

**Minor Modifications to the Texas Guaranteed
Student Loan Corporation Statute
(Chapter 57 -- Education Code)**

Change	Reason	Location in Statute
Substitute "Texas Higher Education Coordinating Board" for "Coordination Board, Texas College and University System".	To reflect the change made by the 70th Legislature.	Sections 57.41(c)(2) and 57.47(a).
Remove the requirement that an eligible lender have its principal place of business in Texas.	To comply with federal provisions added in 1986 that require guarantee agencies to guarantee otherwise eligible loans regardless of the lender's principal state of business.	Subsection (2) of Sec. 57.45.
Remove the prohibition against the corporation or on eligible lender discriminating against an eligible student on the basis of "income."	To comply with federal requirements that loans be made on the basis of financial need.	Sec. 57.50
Delete transition provision.	To remove language that expired in 1981.	Sec. 57.51.

Across-the-Board Recommendations

From its inception, the Sunset Commission identified common agency problems. These problems have been addressed through standard statutory provisions incorporated into the legislation developed for agencies undergoing sunset review. Since these provisions are routinely applied to all agencies under review, the specific language is not repeated throughout the reports. The application to particular agencies are denoted in abbreviated chart form.

Texas Guaranteed Student Loan Corporation

Applied	Modified	Not Applied	Across-the-Board Recommendations
			A. GENERAL
	X		1. Require public membership on boards and commissions.
	X		2. Require specific provisions relating to conflicts of interest.
X			3. Provide that a person registered as a lobbyist under Article 6252-9c, V.A.C.S., may not act as general counsel to the board or serve as a member of the board.
X			4. Require that appointment to the board shall be made without regard to race, color, handicap, sex, religion, age, or national origin of the appointee.
	X		5. Specify grounds for removal of a board member.
*			6. Require the board to make annual written reports to the governor, the auditor, and the legislature accounting for all receipts and disbursements made under its statute.
X			7. Require the board to establish skill-oriented career ladders.
X			8. Require a system of merit pay based on documented employee performance.
	X		9. Provide that the state auditor shall audit the financial transactions of the board at least once during each biennium.
X			10. Provide for notification and information to the public concerning board activities.
		X	11. Place agency funds in the treasury to ensure legislative review of agency expenditures through the appropriation process.
X			12. Require files to be maintained on complaints.
X			13. Require that all parties to formal complaints be periodically informed in writing as to the status of the complaint.
X			14. (a) Authorize agencies to set fees. (b) Authorize agencies to set fees up to a certain limit.
X			15. Require development of an E.E.O. policy.
		X	16. Require the agency to provide information on standards of conduct to board members and employees.
X			17. Provide for public testimony at agency meetings.
X			18. Require that the policy body of an agency develop and implement policies which clearly separate board and staff functions.
X			19. Require development of accessibility plan.

*Already in statute or required.

Texas Guaranteed Student Loan Corporation
(cont.)

Applied	Modified	Not Applied	Across-the-Board Recommendations
			B. LICENSING
		X	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
		X	2. Provide for notice to a person taking an examination of the results of the exam within a reasonable time of the testing date.
		X	3. Provide an analysis, on request, to individuals failing the examination.
		X	4. Require licensing disqualifications to be: 1) easily determined, and 2) currently existing conditions.
		X	5. (a) Provide for licensing by endorsement rather than reciprocity. (b) Provide for licensing by reciprocity rather than endorsement.
		X	6. Authorize the staggered renewal of licenses.
		X	7. Authorize agencies to use a full range of penalties.
		X	8. Specify board hearing requirements.
		X	9. Revise restrictive rules or statutes to allow advertising and competitive bidding practices which are not deceptive or misleading.
		X	10. Authorize the board to adopt a system of voluntary continuing education.