



Iowa Student Loan
Presentations to the Iowa Legislature's Government Oversight Committee,
Oct. 29, 2007

Presentation by Victoria Payseur, Vice Chair of Iowa Student Loan Board of Directors

Good afternoon. We appreciate the opportunity to talk with you about Iowa Student Loan.

Introduction:

My name is Vicky Payseur – Vice Chair of the Board of Directors of Iowa Student Loan and Vice President of Business and Finance for Drake University. With me today is fellow ISL Board member, Tom Gronstal – Chairman of the ISL Board Audit Committee and State Superintendent of Banking and Steve McCullough – CEO of Iowa Student Loan.

We have prepared a formal presentation in which we have attempted to address the issues raised by this committee. There should be ample time for questions after the presentation.

I am going to begin by discussing:

Who is ISL and what is our role in student lending?

A. Our origins and mission – I will also try to provide you with an historical perspective on ISL.

Iowa Student Loan was incorporated as a private nonprofit 501(c)(3) corporation in 1979 at the request of Governor Robert Ray and the Iowa College Aid Commission. They believed that the state was best served by having Iowa Student Loan be a private corporation.

Governor Ray's proclamation included the following:

The program to be established should be as comprehensive as feasible within the limitations of the applicable provisions of federal and state law. Any revenue bonds issued and other obligations incurred for the program should be obligations solely of the not-for-profit corporation. Student loan acquisitions should be made available as soon as the program can be developed and necessary federal approvals obtained.

My reasons for making this request are as follows:

1. Assuring that student loans for post-secondary education are accessible in Iowa at favorable rates of interest and repayment terms is an important objective in our total effort to provide adequate opportunities for our citizens to benefit from education beyond high school.
2. Although commercial lenders in the state have made significant contributions by committing substantial sums for student loans, the need for loans to post-secondary education students exceeds the amount which experience indicates can be made available by commercial lenders.
3. Assuring accessibility to loans for all Iowa students requires establishment of a statewide program to accommodate that portion of student loan demand which commercial lenders cannot meet by providing a secondary market for student loans and last resort loans for students who would otherwise be unable to obtain funds from a commercial lender.
4. In view of the contribution required from Iowa taxpayers to support other post-secondary education programs and institutions and the realities of fiscal restraints, a statewide student loan acquisition program should be provided without support from the state treasury.

As a result, no state money was used to start Iowa Student Loan, and ISL has never received any state appropriations.

Moreover, because ISL is not a state agency, but rather, a private not-for-profit corporation, none of the debt required to fund these student loans – currently \$3.2 billion of debt – is considered debt of the state of Iowa. Also, as a result of its structure as a private nonprofit corporation, ISL has no shareholders to pay, so all earnings are reinvested to benefit the students of the state of Iowa.

Iowa Student Loan's mission is to help students obtain the resources necessary for a postsecondary education – that mission has remained unchanged from the program envisioned by Governor Ray at ISL's inception.

The best interest of the students is at the heart of our mission and our daily actions – that's what makes us different from the for-profit student loan providers.

Those differences will become more obvious as we continue our presentation.

B. Board governance.

Next I'd like to tell you about our governance structure.

ISL is governed by a Board of 11 individuals appointed by the Governor. Board members come from lending institutions, colleges, the general public, the Iowa College Student Aid Commission and the State Superintendent of Banking. This Board composition was first established in 1979 and remains unchanged today.

The Board of Directors hires a CEO, who along with his staff, manage the day-to-day operations of the corporation.

This Board is actively engaged in the oversight of ISL with a keen eye toward ensuring that the mission of assisting Iowa students through low-cost student loans is achieved.

To that end, the Board:

- Meets frequently to review timely information and data on the operations of ISL.
- Approves all significant actions of the corporation.
- Establishes the future strategic direction of the corporation.
- Sets the policies of the corporation.
- Reviews and approves the annual budget.
- Employs outside financial, human resource, computer, auditing and legal experts to advise the Board.
- Oversees audits and reviews of the management of the corporation.
- Evaluates the CEO and sets his compensation based upon a written annual performance evaluation and an independent review of peer compensation at comparable entities.

This legislative committee can have confidence that the ISL Board properly governs the corporation and its activities, and takes very seriously its role as the primary oversight body for Iowa Student Loan.

C. Who we are today – summary.

Iowa Student Loan's original mission was supplemented in 1991 when the Legislature and Governor, at the request of ICSAC, named Iowa Student Loan as the provider of private, supplemental student loans under the Partnership Loan Program. As the demand for student loans has increased, Iowa Student Loan has provided loans for over 300,000 students, grown to \$4 billion in assets and employs 400 Iowans.

D. Achievements in meeting our mission.

1. Low-cost loans.
2. Generate jobs and economic impact.
3. Return earnings to students/Iowans.

The original goals for ISL were to provide low-cost student loans to Iowans; to keep the business and jobs associated with the loans in the state; and to return earnings on the loans back to Iowans. ISL has accomplished these goals by:

- Lowering the cost of student loans for students by paying origination fees and offering below-market rate private loans, and making private loans to students who could not get them from other lenders.
- Iowa Student Loan employs 400 Iowans in good-paying jobs. A recent economic impact study performed by independent experts indicated that ISL's activities stimulate \$237 million in annual consumer spending, 2,400 additional jobs and \$2.3 million per year in additional state taxes.
- Since 1997:
 - ISL has used a total of \$95 million of its funds on behalf of Iowa students to pay down their loan origination fees, provide interest rate reductions to on-time borrowers, and offer free college planning services to all students of the state.
 - In fiscal year 2007 alone, ISL invested \$14.8 million in interest rate reductions and loan fees paid on behalf of students.
 - ISL's future expenditures include firm commitments made in the past, such as \$18 million in loan forgiveness for teachers and nurses that stay in Iowa, as well as for deployed military personnel.
 - ISL has also promised \$43 million in future interest rate reductions to existing borrowers.

ISL has thus far incurred \$78 million in gross loan losses on private loans, mostly made to students whose parents were unable or unwilling to pay tuition, cosign or borrow on their student's behalf. In addition, from the private loans currently on ISL's books, it expects another \$133 million in gross loan losses before these loans pay off. But, those students have been provided the opportunity to attend college.

We believe that the mission of supplying low-cost student loans to Iowans is being fulfilled on a daily basis by ISL. And, we believe that ISL has made a real difference in the lives of Iowans. We are extremely proud of ISL and we believe you can be as well.

I will now ask Steve McCullough, our CEO, to discuss how student loans work.

What do we know about the general problem of student debt in Iowa? The increase in student indebtedness is a problem that is not unique to Iowa. As the College Board reported recently, there is an increase in the use of student loans in general. The percentage increases in private loans in Iowa are reflective of the rest of the nation. However, it appears that Iowans are using a higher percentage of Stafford Loans, and a slightly lower percentage of PLUS Loans, as compared to the rest of the country.

It is important to note that ISL does not create the demand for student loans. Rather it reacts to the demand by trying to supply low-cost loans and by counseling students against over-borrowing. We believe that the demand for student borrowing itself is actually created by other economic factors.

E. Iowa-specific data and research on indebtedness

1. College costs and inflation.
2. State per-capita income.
3. Relatively stagnant aid and limits on federal loans.
4. High college-going rate.
5. Students' vs. parents' responsibility.

Our research identified four factors or trends that account for the high level of indebtedness among Iowa students.

The first factor driving up the demand for student loans in Iowa is the rapid increase in the cost of attending college. Between 1994 and 2004, the cost of attendance for the four-year public schools in Iowa increased 98% compared with the U.S. average over the same period of 69%; between just 2002 and 2004, the increase for Iowa was over 23% compared with 13% for the rest of the country. Obviously, price increases are going to drive up the demand for loans and the amount of student indebtedness.

The second factor is that Iowa ranked 36th in the nation for family income. In fact, family incomes in Iowa trail the national average by approximately \$7,000 per year, which means Iowans have less available dollars to invest in college education and need to seek other sources of financing education.

The third factor identified in the ISL study is the decreased purchasing power of state and federal student aid programs. ITG, Pell and other federal aid have simply not kept pace with the rate of inflation and the increasing cost of higher education.

The fourth factor – a very positive factor for the state – is that more Iowa residents participate in postsecondary education at a higher rate than any other state in the country! Put simply: we have more Iowa students with higher need attending college.

Our final point goes to the composition of student debt in Iowa. Comparing the latest College Board data from ICSAC, it is evident that Iowa students are utilizing their federal loans at a rate higher than other U.S. students, but their private loan proportion is slightly lower than the U.S. in

2005-06. This trend holds true over the past 10 years of available data. Therefore, the existence of the Partnership Loan Program does not cause Iowa to exhibit a higher proportion of private loan debt than the average in the U.S.

Conclusion:

In closing, I want to reiterate some key points:

1. ISL remains focused on its mission – the mission that originated in 1979 under Governor Ray that means offering student loans at the lowest possible cost to Iowans – which is why hundreds of Iowa banks, credit unions, colleges and universities and over 300,000 Iowa students and families choose to partner with ISL.
2. It also means that as a state-based nonprofit we give back to Iowa students any revenue we generate in excess of operational needs and reserve requirements – \$33 million last year.
3. Finally, we understand and concur with many of the recommendations of the state auditor’s report. We are ready to change as needed as long as we can preserve the ISL nonprofit mission and continue to provide Iowans with financial access to postsecondary education at the lowest possible cost.

Thank you. We look forward to answering your questions.

Presentation by Steve McCullough, President and CEO of Iowa Student Loan

What Loans does Iowa Student Loan Provide?

I had originally planned to present information about how the financial aid process works. Since Karen Misjak of ICSAC already covered this topic, I will focus my comments on ISL's specific role, and move directly to answering some of the questions that were raised earlier today.

Iowa Student Loan is involved with two separate, distinct loan programs: government-guaranteed student loans and private, non-guaranteed student loans. It has been acting as a student loan servicer and secondary market for government guaranteed loans since it began operations in 1981. ISL works with over 300 lenders in Iowa, helping them make student loans. These services are supplied by Iowans. Iowa Student Loan does not outsource our work to others.

Iowa Student Loan receives certification information from colleges on behalf of its partner lenders, and forwards the certification to the state guarantor, who grants the loan guarantee on behalf of the federal government and transfers money from its serviced lenders to the college. The college then applies the funds to the student's account at the college, and hands the remainder over to the student to pay for living expenses. Iowa Student Loan buys individual loans from its partner lenders and works directly with the student as loans are repaid.

Iowa Partnership Loans and PLUS Loans

Beginning in 1991, at the request of ICSAC and with the authorization of the State Legislature, ISL began making Iowa Partnership Loans to families who could not otherwise obtain enough financial aid for college. These loans are certified by the financial aid office at the college to make sure that families do not borrow more than they need to pay for college. ISL agrees with ICSAC that "Direct-to-Consumer" private loans should be banned, because they circumvent the financial aid offices at the colleges.

Iowa Student Loan, its College Planning Center and the colleges counsel students to avoid over-borrowing and to use all available government-guaranteed loans before using private loans.

Are there programs that offer a better deal for the highest income families with the highest credit rating? Yes, because ISL's program is targeted to be the best for middle- to low-income families. Especially since ISL is using tax-exempt bonds to fund part of the program, we have adhered to the philosophy of targeting the program at these families.

In 2005, ISL was contacted by ICSAC with the request that we join with them in promoting PLUS loans to Iowa parents, in part because ICSAC generates revenues from PLUS loans. ISL's Board of Directors immediately approved a special offer of eight months' free interest from parents that borrow PLUS loans, and ISL began a special marketing campaign to encourage parents to borrow PLUS loans on behalf of students. We did this because we want them to consider PLUS loans first.

Comparison to Other Nonprofits

Mr. Shireman compared our loan program to those of three state agency nonprofits that receive up to seven times more tax-exempt bonding authority, which means that they can fund their programs at a cheaper rate and are better able to offer lower rates. Moreover, the New Jersey program should not be compared to that of ISL because New Jersey receives \$270 million in tax exempt bonding authority every year, as compared to ISL's \$40 million per year, and does not make loans to students without a creditworthy cosigner, unless they are a creditworthy graduate student.

But no other provider provides private loans like ISL's, which are available to all students, even those without any credit history whatsoever. These students may not otherwise be able to attend college because their parents are unable or unwilling to borrow on their behalf.

Iowa Student Loan Audit Follow-up and Summary

ISL will be supplying its financial audit to the committee as requested, along with the reports on Partnership Loans suggested by Mr. Shireman, assuming that all of this data is available. It is important to note that no state money was used to start ISL, and it has never received any state appropriations.

Iowa Student Loan borrows money by issuing bonds to investors. None of these bonds are obligations of the state. ISL was started as a private corporation to avoid any obligation by the state for ISL's bonds. It is important to note that these bonds are not exempt from state taxes, but only from federal taxes. It is the IRS that regulates these bonds, not the State of Iowa. These bonds require ISL to have positive earnings, because bond investors will not invest in money-losing transactions. They want to make sure that adequate collateral exists to repay the bonds. ISL also needs to build reserves to ensure against risks such as loan losses on non-guaranteed private loans. After ISL reaches adequate collateral and reserve levels, it can return earnings to Iowa families through the payment of upfront loan fees, interest rate reductions, loan forgiveness and the reinvestment programs that will be detailed by Tom Gronstal.

Presentation by Tom Gronstal, State Superintendent of Banking and Chairman of the Iowa Student Loan Board Audit Committee

Iowa Student Loan External and Internal Audits

The audit committee engages outside independent auditors to perform audits verifying the financial statements and operation of Iowa Student Loan Liquidity Corporation.

These audits include:

- Annual financial statement audit.
- SAS 70 audit of internal controls, including computer systems.
- Annual U.S. Department of Education lender audit.
- A-133 audit of ISL servicing operation.
- Agreed-upon procedures audit for ISL creditors.

Additionally, the Iowa Division of Banking performs an annual review of the Iowa Student Loan Liquidity Corporation to ensure compliance with the Iowa Consumer Credit Code and federal Truth in Lending.

The U.S. Department of Education periodically reviews ISL's compliance with the federal regulations.

In addition to the audits performed by the external auditors, the audit committee has established internal audit functions within the corporation to audit and evaluate compliance with established Board policies.

The ISL Board's Human Resources Committee also engages outside consultants to perform peer surveys and evaluate executive compensation and Board fees.

The audits performed at the direction of the Iowa Student Loan Liquidity Corporation's Audit Committee by independent outside auditors meet and exceed the required audits of state-chartered federally insured depository institutions. All of the audit reports I have reviewed on ISL's financial statements received unqualified opinions of the auditors. This means the auditors believed ISL's financial statements were accurate and fairly represented the true financial condition of the corporation.

There should be no doubt that the Iowa Student Loan Liquidity Corporation Board of Directors is diligently overseeing the management and operation of the corporation.

Iowa Student Loan Equity and Reserves

The equity and reserves of the corporation are extremely important. There have been questions raised that ISL has not used enough of its reserves and equity to benefit students. The primary function of ISL is to provide a secondary market for student loans.

ISL fulfills this mission by purchasing student loans issued by more than 300 financial institutions. ISL funds the purchase of these student loans by selling bonds through investment banks. Essentially, ISL borrows money from investors to fund its purchase of student loans.

When ISL sells bonds, the investors require more collateral to be pledged than the amount of money borrowed. ISL's equity and reserves are the source of this additional collateral.

In order to continue to serve as a secondary market for student loans, ISL must continue to have adequate equity and reserves.

ISL's Board has established mechanisms to determine the minimum required equity levels for the corporation. The corporation's actual financial position and its budgeted financial performance are frequently compared to the required minimums. This analysis provided the basis for ISL's Board to determine how much the corporation can spend on borrower benefits.

It is important to remember that as a nonprofit corporation, ISL's only source of new capital is from the net income it generates. ISL cannot issue stock to investors to raise equity.

In 1997, the Board recognized the level of equity in the corporation would allow funding of more programs to help students. The Board authorized the use of more resources to help students. These programs have resulted in reducing ISL's equity-to-assets ratio from approximately 10% to about 5% in the last 10 years.

By way of comparison, the Iowa Division of Banking requires state-chartered banks to maintain a minimum of 6.5% equity plus a fully funded loan-loss reserve. Currently the state average equity-to-asset ratio for state-chartered banks is 9.58%.

As we look to the future, new federal legislation has significantly reduced the revenue streams for ISL and the subprime mortgage problem makes selling bonds more expensive. Further reduction of ISL's equity-to-asset ratio is not warranted at this time. With the challenges the corporation faces in the future, it will be difficult to maintain the current borrower benefit programs, much less initiate new ones.

Iowa Student Loan Compared to For-profit Lenders

Now I want to give you a comparison of Iowa Student Loan Liquidity Corporation and some of its for-profit competitors who have been criticized for taking advantage of federal student loan subsidies. Please turn to the tab labeled “Addressing Current Concerns” in your notebook.

The primary difference between Iowa Student Loan Liquidity Corporation and the criticized for-profit private lenders is in our mission. ISL’s mission is to maximize benefits for Iowa students and their families. The for-profit lenders’ goal is to maximize earnings for shareholders.

ISL uses its earnings in excess of required reserves to fund borrower benefits and community reinvestments to benefit Iowans. The for-profit lenders pay dividends to shareholders with their earnings.

ISL charges below-market interest rates and helps cover fees for Iowa borrowers. The for-profit competitors charge market rates and fees.

ISL advises students to borrow under federal programs first, provides counseling to help students avoid borrowing too much and to find scholarships and grants. Several of the for-profit competitors appear to have engaged in deceptive practices enticing students to borrow more than necessary.

ISL complies with the applicable laws and regulations governing student loans as validated by outside audit and legal counsel. Several for-profit lenders appear to have violated laws and used inappropriate compensation to generate business.

There is no required quid pro quo for participation in ISL programs. Some of the biggest users of ISL’s programs are schools whose students do not use loans from ISL because they are Direct-lending schools. Many for-profit lenders provide program support based on loan volume.

ISL does not market other products to students or sell its information to anyone. Some for-profit lenders market credit cards, car loans and other financial products to their student borrowers.

ISL has endorsed federal legislation which will bring other lenders to use the good practices which ISL already follows. Some for-profit lenders oppose this legislation, which redefines the appropriate relationships between lenders and colleges.

Promoting Financial Responsibility

Iowa Student Loan Liquidity Corporation helps students borrow the money they need for college. It helps reduce their debt by paying the upfront fees and lowering interest rates. ISL helps students and their parents find other types of aid, and educates students about financial responsibility.

In your notebook you will find material describing the Iowa College Access Network (ICAN).

There is also a copy of the “College Planning Guide” and a brochure titled “Student Loan Facts.” This brochure describes the various types of student loans. Under Private Student Loans it lists ISL, Citibank and Wells Fargo as providers of these loans.

Some of the programs sponsored by ISL are:

- The College Planning Center, which helps students applying for college with scholarship searches and completion of the FAFSA.
- Presentation of “Beware of Credit Card” seminars and literature.
- Presentation of financial literacy seminars and distribution of literature to high school and college students.
- ISL has special disclosures on its private loans advising students to use other forms of aid first. ISL provides a budget work sheet for use by private loan borrowers.
- ISL, along with the Iowa College Aid Commission, promotes PLUS Loans in an attempt to have parents borrow on behalf of their students.

Addressing Potential Conflict of Interest

Finally, I would like to address the potential conflict of interest cited by the state auditor. This potential conflict has the remotest chance of occurrence.

The Division of Banking examines ISL for compliance with the Iowa Consumer Credit Code and federal Truth in Lending regulations.

The ISL Board has pricing policies and lending procedures which prohibit violation of the Iowa Consumer Credit Code and federal Truth in Lending regulations. If the examination were to expose a violation, my interest as a regulator and a Board member would be exactly the same – to bring the corporation into compliance and make sure violations did not occur in the future. All of the examinations of ISL so far have found no violations.

Iowa Student Loan Board Response to State Auditor

On behalf of the Board of Directors of Iowa Student Loan, the following response to the state auditor review and our plans in that regard are presented to the Iowa General Assembly.

First and foremost, we are pleased that the auditor's review in the area of ISL finances and audits validated the fact that ISL's financial statements and audits do not indicate there are any financial irregularities or misconduct at ISL. On the contrary, the auditor noted that ISL is subject to a wide range and large number of audits and regulatory reviews, and did not note any particular findings of concern in those reviews. We are pleased to finally have third-party validation that ISL is well managed.

At the same time, ISL is ready to voluntarily and proactively make a number of modifications consistent with the auditor's report in terms of Board organization and our interactions with the state government, which would allow us to further enhance Iowans' confidence in the organization. Specifically, we would anticipate proactively taking the following steps:

1. We will modify our Board structure in a way that increases public membership and removes the two seats of potential concern noted by the auditor.
2. We will support a legislative change (required) removing ISL's Board position on ICSAC. In the interim we will have our Board member resign from ICSAC.
3. We will voluntarily submit our annual audits to the state auditor as suggested in the auditor's report, and provide other information the state auditor might request.
4. We will incorporate the appropriate provisions of Chapter 21 of the Iowa Code related to public meetings into our bylaws, making us subject to those provisions prior to the convening of the next legislative session.
5. We will provide a formal annual report to the governor and the general assembly describing our activities and their impact on Iowans consistent with our mission to assist Iowa students and their families.
6. We will end the practice of fee payments beyond actual expenses incurred for any Board members who are public employees.
7. We concur with the recommendations regarding continued mechanisms for state oversight inclusive of annual Division of Banking examinations, and various federal regulatory reviews and audits, and will continue to submit to such review.
8. We anticipate strengthening a continued working relationship with the attorney general regarding consumer and related issues.
9. And, we will work with the governor to expedite the process for his appointment of additional public members to our Board.

It is our desire and our intention to implement these suggestions as quickly as possible, while continuing to focus our attention on the important work providing needed resources and services to Iowa students and their families, which is our enduring mission.