STUDENT LOAN AVAILABILITY IN MONTANA AND THE IMPACT OF BOND MARKET PROBLEMS:

AN UPDATE ON THE MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION (MHESAC) AND THE STUDENT ASSISTANCE FOUNDATION (SAF)

A Report Prepared for the

Legislative Finance Committee

By

Alan G. Peura

Fiscal Analyst II

June 6, 2008

Legislative Fiscal Division

www.leg.mt.gov/css/fiscal

STATEMENT OF THE ISSUES

At the March meeting of the Legislative Finance Committee (LFC), members requested a report on student loans in Montana with specific emphasis on the ongoing difficulties that the Montana Higher Education Student Assistance Corporation (MHESAC) is having relative to their auction-rate bonds that are used to finance much of the overall student loan market in Montana (approximately 75 percent). During February through mid-April 2008, MHESAC bond holders have not been able to sell more than $1.25 billion of auction-rate bonds. When these bonds do not sell on the auction market, the interest rate that MHESAC must pay on the bonds increases, which has an impact on the overall expenditure level of the organization.

An auction-rate bond is a debt instrument (what an organization sells to borrow money) that has a long-term maturity period (when that debt is ultimately due to be repaid in full) during which the interest rate that the bond issuer pays to the buyer/investor is reset on a regular basis by re-selling of the bonds in an auction. Auction-rate securities have been traded since at least the late 1980s, but have become very popular lately because they do not require a backup letter-of-credit from the bond seller that would ensure that the holder will have a purchaser to buy the bonds when they are ready to sell. Therefore, auction-rate bonds have lower financing costs or lower interest rate costs for the seller, and for the buyer the bonds provide a short-term investment at a good interest rate that is expected to be resold within 35 days. This periodic auction process is designed to enable the holder to effectively sell his position in the bonds to another buyer so that this investment is considered to be almost a cash equivalent. As long as these bonds keep selling through the regular auctions, the costs and return rates appear to meet the needs of both the seller and the investor. When these bonds do not sell on the auction market due to an insufficient number of buyers - new or existing - the auction is considered to have failed. A failed auction typically causes the seller's costs to increase with higher interest rates per a formula dictated by the particular contract and the buyer/investor may lose confidence in the bonds as their investment no longer provides for quick access to cash since the bond cannot be sold at auction.

For a historical comparison, from the late 1980s through 2007, there were 44 failed auctions in the auction-rate bond market [none of those involved MHESAC or the student loan industry], while in 2008, through mid-April, about 395 of 641 bond auctions have failed.[1]

These difficulties in the bond market come on the heels of ongoing concerns raised by the legislature and the executive about the governance and management structure of MHESAC and their affiliate organization, the Student Assistance Foundation (SAF), relative to the optimal level of state oversight of their operations, including the amount of debt that the organizations take on to finance student loans, the type of financing vehicles used (e.g. auction-rate versus variable rate demand bonds), and whether this debt load could have a negative impact on State of Montana bond ratings. These ongoing legislative and executive concerns have been illustrated by:

- HB 578 of the 2007 regular session of the legislature that sought to expressly require that MHESAC comply with public participation and right to know statutes (Section 2-3-101, *et.seq*, MCA), including expanding access to MHESAC financial records by the Legislative Auditor. HB 578 died in the House State Administration Committee. This bill is attached as "Appendix One."
- Board of Regents Taskforce on Student Loan Issues, which was created in late 2007 to address ongoing concerns raised by the executive relative to state government liability for MHESAC debt and the appropriate level of accountability to state government. Membership of this task force includes the Governor's Budget Director. The Taskforce report of March 2008 is attached as "Appendix Two."

With this background and context in mind, LFC member Senator Wanzenried raised concerns relative to this matter and the LFC requested that staff prepare this report for the June 2008 meeting in order to provide:

- a brief history of MHESAC and SAF, including their mission, organization, and student loan operations
- a brief overview of how MHESAC interacts with the Guaranteed Student Loan Program under the Office of the Commissioner of Higher Education
- the impacts of the bond market distortions upon the availability of student loans for Montana students

- an overview of the liability concerns for state government related to MHESAC business practices and debt load

This report attempts to address each of these background areas and ends with questions that LFC members may want to ask officials from MHESAC and SAF to respond to that go into more detail on the current situation and address potential issues.

It should be noted that this report is intended to be informational in nature, to clarify the existing situation, to help facilitate the situation prospectively, and to allow for LFC discussion, with no action options presented for legislative consideration at this time.

HISTORY AND OVERVIEW OF MHESAC AND SAF

MHESAC was incorporated in 1980, as authorized by the Montana Board of Regents,[2] as a private non-profit corporation that would provide a secondary market for student loans in Montana, using tax-exempt financing. At that time, there was concern that primary lenders in Montana, oftentimes banks, would limit the size of their student loan portfolios, thus resulting in a shortage of funds to meet the growing demand for student loans. The solution to this problem was to create a secondary loan market: a corporation that would be able to purchase loan portfolios from the direct lenders who would then have the funding available to continue to offer loans to Montana students.

The creation of MHESAC essentially created a two-tiered lender structure in Montana for student loans: the primary lenders who make loans directly to the students and families, and the secondary lender who then purchases a bundle of those student loans from the banks so that secondary lender is then responsible to service that loan, including establishing a repayment program with students as they graduate. This became the role of MHESAC starting in 1980, to serve all the functions of a secondary lender in the Montana student loan market for students attending the higher education institutions of the Montana University System as well as the tribal and private colleges in the state.

MHESAC RELATIONSHIP WITH GUARANTEED STUDENT LOAN PROGRAM

At this point it is important to distinguish this function of MHESAC as very different from the role of the Montana Guaranteed Student Loan program (GSL), which is a state agency under the management of the Montana Board of Regents (Regents) through their staff, the Commissioner of Higher Education. GSL is a federal government funded state agency, authorized at Section 20-26-1101, *et.seq*. MCA, that guarantees student loans by agreeing to purchase defaulted loan accounts from both primary lenders and secondary lenders. This guarantee of a purchaser for defaulted loans, guaranteed with federal government funding, creates an acceptable level of risk so that lenders are willing to provide loans to students who do not otherwise meet most of the credit rating criteria as an acceptable risk level.

GSL provides guarantor services to all eligible lenders in Montana who provide either primary student loans or secondary student loans. This includes MHESAC who is an eligible lender, as student loans held by MHESAC where the student borrower defaults are purchased by GSL with federal funding, just as GSL does with all public and private lenders who meet the eligible student lender criteria.

Therefore, the role of MHESAC as a secondary loan market is to ensure that there will be sufficient funds available in Montana to meet the demand for student loans, while the role of GSL is to provide the fiscal guarantee to all eligible lenders that student loan defaults will not create an unreasonable risk so that lenders are willing to make these loans to students.

OPERATIONAL AND ORGANIZATIONAL STATUS OF MHESAC

As a non-profit corporation, MHESAC operates with a Board of Directors consisting of seven voting members, three members from the Regents, and four at-large members. These seven members of the MHESAC board are,

in accordance with the corporate bylaws, appointed by the Chairman of the Board of Regents. In addition, the Commissioner of Higher Education serves as an ex-officio, non-voting member of the MHESAC Board. In order to carry out their functions as a secondary market lender for student loans in Montana, MHESAC employed an Executive Director who since 1984 has been James Stipcich.

Montana law, at Section 17-5-1301, MCA, *et.seq*, allocates to MHESAC a specific percentage of Montana's tax exempt bond authority, as MHESAC is authorized by federal law to issue tax exempt bonds to investors as a means to raise the funds necessary "to provide student loan capital to the student loan program established by the board of regents of higher education." Section 17-5-1302(15), MCA, defines MHESAC as a "state issuer" solely for the purpose of allowing MHESAC to issue tax-exempt bonds and clarifies that this definition is "for this part only."

Therefore, from 1980 through the late 1990s, MHESAC operated as a private non-profit corporation, created by the Montana Board of Regents to serve as a secondary student loan market to ensure that Montana residents would have access to student loans, while the funding for this corporation was primarily raised by selling tax-exempt bonds. MHESAC also served as a primary lender of consolidation loans to students, and the corporation did expand their products to include a loan rebate program to help primary lenders provide lower student loan interest rates to Montana residents as well as providing information/outreach programs for students to help them with the financial decisions of paying for a higher education. Finally, MHESAC, under the direction of a seven member board with at least three members from the Regents, did not serve markets or students outside of the state of Montana.

MHESAC RESTRUCTURES

In the late 1990's, as conditions in the student loan and the larger financial markets changed, there was less activity and loan volume in the secondary loan market and MHESAC projected a revenue reduction and a decline in asset value of the corporation. This created board concern about the fiscal future of a solely secondary student loan market corporation and MHESAC hired a consultant in 1998 to develop a range of options for board review. The result is that MHESAC considered and ultimately approved a recommendation to restructure the corporation[3].

The primary form of this restructuring occurred in September of 1999 when the Student Assistance Foundation (SAF) was created as an affiliated corporation to MHESAC. Structurally, SAF would become the employer of staff, who would migrate from MHESAC to SAF, and this new affiliate corporation would provide management services to support MHESAC. The restructuring plan would not change the ability of MHESAC to have access to the federally authorized, state-allocated, tax-exempt bond financing.[4]

From a business product perspective, a significant result of the restructuring was the creation of the SAF affiliated corporation for the purpose of expanding new loan servicing products, provided both inside as well as outside Montana, and the expansion of additional public benefit opportunities such as grants to students.

MHESAC, following the restructuring, has pursued a clearly stated strategic goal of becoming the dominant primary lender in the Montana student loan market as well as continuing to serve as the secondary student loan market in Montana, with loan servicing contracted to SAF.

The statutory authority for MHESAC to sell tax exempt bonds, together with the non-profit corporate status, means that these affiliated corporations have the opportunity, as opposed to for-profit businesses, of offering lower loan interest rates to students as well as a number of other financial benefits to borrowers. By 2008, nine years after restructuring, the two corporations list the following as their respective business products and services:

- MHESAC
    - Issues tax-exempt and taxable bonds [to raise funds for student loans]
    - Originates and acquires Montana student loans [as a primary and secondary market]

- Acquires non-Montana student loans
- Provides borrower benefits [reduced interest rates, payment of origination and default fees, rebates, etc.] for Montana students from its financings[5]

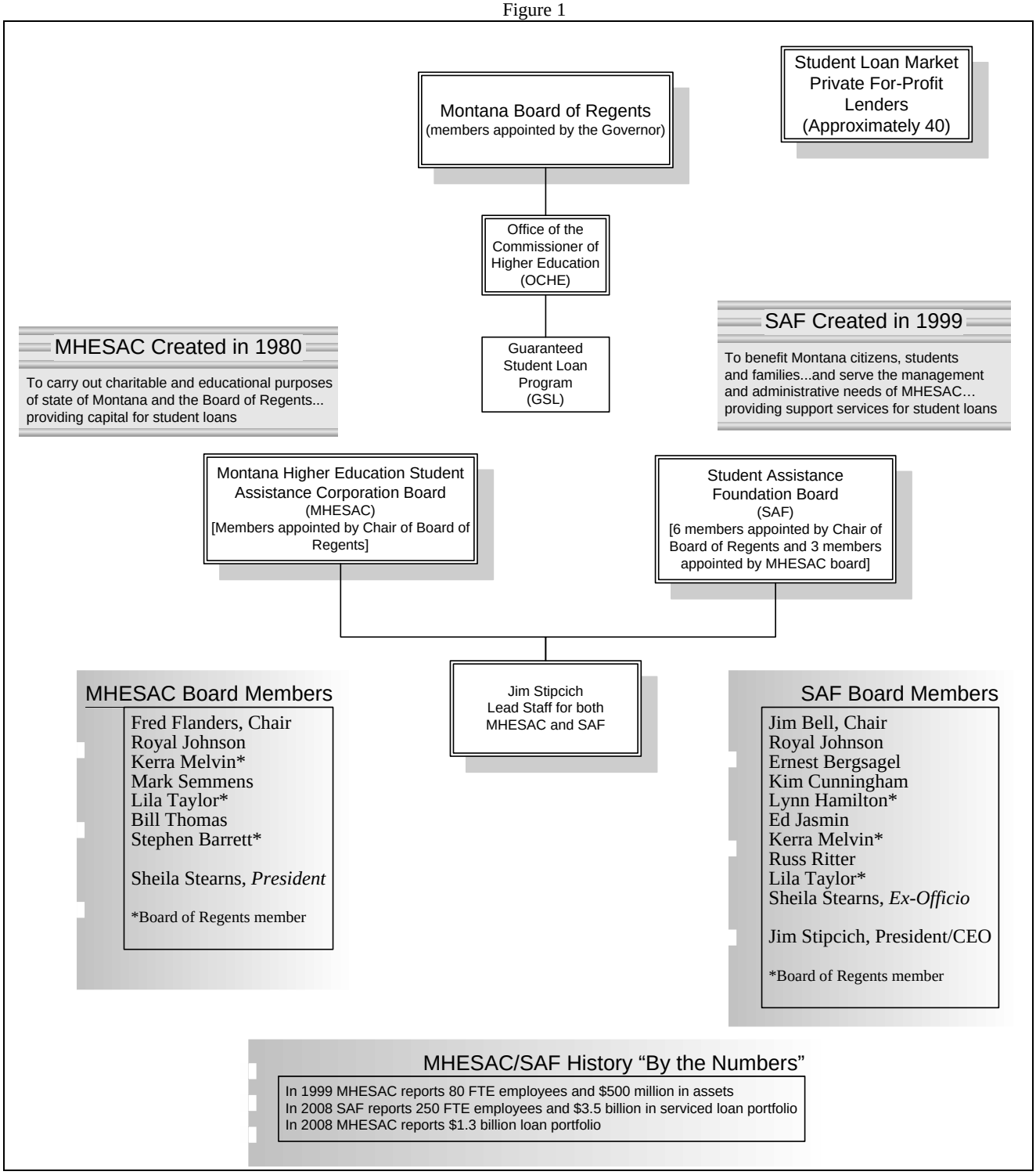
These borrower benefits are funded primarily as a result of the non-profit, tax-exempt status of MHESAC, as federal tax code requires that non-profit student loan corporations may only retain a certain percentage of the "profits" from their financings. Any amount above that level must either be returned to the federal government or invested in financial benefits to support student borrowers, such as those specific benefits listed above from the MHESAC website.

- SAF
  - Servicing student loans
  - Financial planning for college: information, community outreach
  - Grants
  - Access and affordability programs
  - Third party loan services
  - Corporate loan generation services
  - Management of 150(d) corporations[6]

SAF also states that it has provided "more than $3.1 million in grants to Montanans" since the year 2000,[7] benefits that the corporation reports are funded by the surplus revenue that SAF generates through its operations. Neither MHESAC nor SAF receives any funding from the State of Montana.

In terms of organizational structure for MHESAC and SAF, the original recommendation for restructuring included that each corporation would have the same board, but in fact each has its own board though James Stipcich is the authorized representative or lead staff for both corporations, with MHESAC contracting with SAF for staffing and management services. Figure 1 below illustrates the respective board structures and the relationships with other entities involved with student loans in Montana:

Figure 1



As Figure 1 illustrates, the Montana Board of Regents appoints members to both boards of directors and three Regents serve on each board. In addition, the Commissioner of Higher Education, Sheila Stearns, serves as the lead corporate officer of MHESAC and serves as an ex-officio board member of SAF. Therefore, there is coordination between the Regents and these two private corporations that were created for a public purpose and public benefit on behalf of the Montana Board of Regents. It should also be noted that while MHESAC has the largest market share of the Montana student loan market, there are also approximately 40 additional private, for-profit lenders that include institutions such as U.S. Bank and Wells Fargo who make student loans in Montana.

MISSION AND PUBLIC BENEFIT PURPOSE

The articles of incorporation of MHESAC state that "this Corporation is a public benefit corporation…to carry out charitable and educational purposes of, the State of Montana and the Board of Regents of the Montana University System."[8] This is what is known as the "public purpose" in Montana of MHESAC, its primary role to ensure that there are always funds available for Montana students to acquire student loans to pursue their higher education and to help reduce the cost of those loans for students. From its inception in 1980, this public purpose has served as the justification for MHESAC and the basis upon which Montana statute authorizes tax-exempt bond status to this private corporation.

Since restructuring and subsequent expansion into the primary loan market, MHESAC quantifies the FY 2007 benefits that it has passed along to Montana borrowers, using the revenue surplus it has available as a non-profit corporation, to include more than $5 million of borrower benefits, specifically through reduced interest rates and loan origination and default fees.[9]

The articles of incorporation of SAF, like those of MHESAC, also state that this Corporation is organized "to carry out the purposes of the State of Montana, the Board of Regents…" In addition, SAF is created in order that "this Corporation shall serve the management and administrative needs of the Montana Higher Education Student Assistance Foundation [MHESAC]…shall engage in, advance, support, promote, and administer charitable and educational activities…"[10] As a non-profit corporation with a charitable and educational purpose, SAF uses its revenue surplus to fund a number of what it defines as public benefits, including grants and sponsorships that support Montana students as well as outreach to provide advice and counsel on financing the costs of higher education. In terms of business operations, SAF staff service student loans both within Montana as well as outside of the state.

EXPANSION OF MHESAC AND SAF

ENTRY INTO THE NATIONAL STUDENT LOAN MARKET

In 2000 MHESAC expanded into the national, non-Montana student loan market as the corporation began to purchase loan portfolios from primary lenders outside Montana for non-resident students. In addition, SAF offered consolidation loans to students outside of Montana as well, though the SAF board suspended all the non-Montana loan business in October 2007. In both cases, these purchased and consolidated loans are serviced by staff with SAF as the affiliate organization.

The boards for MHESAC and SAF believe that expansion into the non-Montana market has allowed them to also expand the amount of revenue that is invested into the public purpose/public benefit missions of the organizations on behalf of Montana students.

According to MHESAC/SAF fiscal data, the total volume of the borrower and public benefits have changed as follows in the years subsequent to FY 2002, when the corporations' most substantial non-Montana market business began:

- MHESAC reports $17.2 million in borrower benefits for FY 2003 through FY 2008 to date, compared to $21 million from its inception in FY 1981 through FY 2002[11]
- SAF reports $10.9 million in public purpose benefits delivered from its inception starting in FY 2000 through March 31 of FY 2008 (less $2.6 million for benefit programs administration)[12]

But, it is the growth of the loan portfolio of MHESAC and the speed of that growth, specifically the non-Montana market financed with taxable bond debt (totaling $648 million through 2007[13]) that has created concern among some state government officials, including the executive budget office. The concern is that this growth in debt may be hurting the overall Montana student loan program market by jeopardizing the fiscal viability of the MHESAC/SAF corporate model, its ability to continue the role of a secondary student loan market, and that

this growth in debt load and the possible fiscal failures of this corporation could potentially create risk to other state bond ratings.

According to the MHESAC year-end performance report, the corporation had a loan portfolio of $1.39 billion in June 2007, of which $874 million was for 78,936 Montana borrowers while $517 million was for 17,900 non-resident borrowers across the country. This student loan portfolio of Montana and non-Montana market is financed by outstanding debts and notes of MHESAC that totaled $1.8 billion on June 30, 2007, among which a total of $1.2 billion is tax exempt bonds issued by MHESAC as part of the Montana Unified Volume Cap Bond Allocation (Section 17-5-1301, MCA), with the remaining $600 million as taxable bonds issued.[14]

Finally, in addition to this level of bond debt, the financial statement for SAF at the close of FY 2007 also reports that the SAF subsidiary known as the Montana Student Loan Funding, LLC, is warehousing some $141 million of non-Montana consolidation loans that are to be purchased at some point by MHESAC[15]. This creates an additional need for MHESAC taxable bond sales, separate from the need to finance future student loans, in order to raise the funding to purchase these warehoused loans from their affiliate corporation SAF.

DISCUSSION OF THE ISSUES

As stated earlier, the increase in debt and the use of certain debt financing instruments has led to concerns related to two primary issues:

1. Will financial difficulties within the MHESAC and SAF corporations create strict liability or reputational liability problems for the State of Montana
2. What are the impacts of MHESAC and SAF debt load and bond financing difficulties upon the availability of funding to meet Montana student loan needs

POTENTIAL LIABILITY ISSUES FOR THE STATE OF MONTANA

In mid-2007, when a number of changes to the guaranteed student loan program reduced the profitability of the student loan business, most acutely for the private for-profit companies, MHESAC staff and board began their due diligence "bid development process" to consider the acquisition of a $900 million student loan portfolio from The Student Loan Marketing Association (Sallie Mae).[16] That MHESAC bid development process is attached as Appendix Six. While that $900 million acquisition ultimately fell through and MHESAC did not acquire that additional portfolio and the associated debt, financed by taxable bonds, that process triggered an immediate letter of concern from the executive budget office.

That letter of October 15, 2007, attached as Appendix Five, is written by budget director David Ewer and expresses a concern specific to the $900 million of taxable bond debt that would be necessary to acquire the Sallie Mae portfolio but goes on to express general concerns including:

- "I believe that MHESAC has a responsibility to consider not only the impacts of its business decisions upon itself, but to other state bond issuers and the state's own credit. I do not believe that MHESAC's bond issuers are risk-free to the rest of state government."

These concerns are based in part on a letter addressed to budget director Ewer from the state's financial advisor, Piper Jaffray. That letter indicates concern by Piper Jaffray about the implications that a default or other financial difficulties experienced by MHESAC resulting from extensive bond debt could have on the bond rating for the State of Montana. That letter of October 15, 2007, attached as Appendix Four, concludes:

- "In my opinion, every agency of any state needs to be cognizant of the fact their operations can have an impact on other state agencies. While one state agency may be able to explain that there is no "credit connection" between itself and another agency, the institutions buyer of both tax-exempt and taxable bonds will be very thorough in its due diligence before purchasing any securities, and will uncover any problems or concerns about the specific credit in question as well as other concerns they may have about these other state agencies."

One assertion in this letter that remains in dispute is the assertion that MHESAC is a "state agency" in the same manner that other executive branch agencies are defined. Once again, in Section 17-5-1302(15), MCA, MHESAC is considered a "state issuer" of tax exempt bonds but only for the purpose of that authority to sell bonds as a tax-exempt entity. There is no other definition in statute that specifically or expressly defines MHESAC in any way as a state agency.

While legislative legal staff has not opined on this matter in response to any of the issues raised by these letters, legislative staff discussion has concurred with the conclusion that there is no strict or legal, statutory liability of state government for the business operations of MHESAC and SAF. The concept of "reputational" liability on state bond ratings has not been explored at this point.

As a result of these letters and the concerns raised by the executive budget office in Appendix Four and Five, the Regents created the Task Force on Student Loan Issues, discussed above, that has issued the attached report and continues to meet in order to address and try to resolve ongoing issues of accountability, communication processes, related concerns about state liability, and the optimal oversight relationship between the Regents or state government and MHESAC/SAF.

IMPACT OF BOND MARKET DISTORTIONS ON MHESAC AND SAF

When investors are unable to sell auction rate bonds sold by MHESAC, the bond interest that MHESAC must pay to those investors increases, which has an impact on the corporation by increasing the expenditures required to service the outstanding debt. As discussed earlier, during February through mid-April 2008, MHESAC bond holders have been unable to sell more than $1.25 billion of auction-rate bonds, which typically roll-over for auction every 35 days.

According to the year-end performance report for MHESAC, the actual interest rates for the tax-exempt bonds were variable between 3.82% – 4.0% and the taxable auction rate bonds were paying interest rates in the range of 5.270% - 5.288%. This illustrates the lower cost/higher profitability for MHESAC of the tax-exempt bonds versus the taxable bonds, and it illustrates the projected expenditure level that MHESAC had anticipated prior to the inability of their bonds to be resold on the auction-rate market.

Once again, each time the auction-rate bonds are unable to be sold when they reach their rollover date, the interest rate paid by MHESAC to investors on those bonds may increase.

Thus far in FY 2008, MHESAC has experienced an unbudgeted increase of $14.04 million in expenditure costs related to paying higher interest rates on bond debt for the auction-rate bonds[17]. This includes $13.1 million of costs on tax-exempt auction rate bonds and $940,000 on taxable auction-rate bonds.

The mix of MHESAC bonds issued between 2000 and 2007 (since restructuring) indicates that 83.8 percent of the tax-exempt bonds are auction-rate bonds, versus variable rate demand obligations, while 26.1 percent of the taxable bonds issued are auction-rate versus floating rate notes, for a total, overall bond debt portfolio mix of 62.2 percent auction-rate bonds during those years.[18]

Considering all years, the current outstanding bonds for MHESAC indicates that 61.2 percent of the tax-exempt bonds are auction-rate bonds, versus versus variable rate demand obligations, fixed rate, or zero coupon bonds, while 5.2 percent of the taxable bonds are auction-rate bonds versus floating rate notes. Therefore, the total mix of current outstanding bonds for MHESAC is 66.4 percent auction-rate bonds.[19]

As a result of these increased costs to MHESAC, SAF announced on April 24, 2008 that it has reduced its staff by 23.0 FTE, citing the recent "credit crisis," reduced servicing volume, and the request that SAF received from its affiliate organization, MHESAC, to reduce operating expenditures.[20] Prior to this latest staff reduction, in the past year SAF had already reduced staff by some 35.0 FTE. Taken together, this reduction of 58.0 FTE in the past year represents approximately a 23 percent overall staff reduction. In addition, MHESAC recently

announced that it is reducing the level of borrower benefits that support Montana students, and that the corporation is also eliminating its consolidation loan program for Montana student loan borrowers.

National Implications of Bond Market Issues

Given the international nature of the auction-rate bond market and the level to which the national guaranteed student loan secondary market is financed by auction-rate bonds, it is no surprise that Montana is not alone in confronting concerns related to student loan funding availability. In fact, in many other states, the problems are much more serious as lenders who represent some 14 to 16 percent of the student loan market have announced that, starting in the fall of 2008, they will not be making loans in the coming academic year. In late February, the Pennsylvania Higher Education Assistance Agency announced that it would not be able to provide financing for student loans, starting immediately. This has triggered Pennsylvanian State University to start the process to rejoin the federal direct student loan program so that their students would be ensured access to student loan financing.

Specific to Montana, MHESAC reports that they have some $175 million of funding in place for student loans during the 2008-2009 academic year. Their funding availability beyond that is less clear, leaving the future availability of student loans from MHESAC in question after the next academic year, for both primary and secondary loans. It is important to note, however, that in addition to MHESAC some 40 private lenders also offer student loans in Montana.

On the federal level, Congress and Administration officials are looking at the options that exist to ensure sufficient funding for the federal student loan program, including an infusion of federal funding to private lenders, letting the future loan volume migrate to the federal direct student loan program, revisiting federal legislation in September 2007 that reduced private lender incentives for student loans, and the idea of using secondary loan market "lender-of-last-resort" provisions that would assign guarantee agencies (in Montana that would be the GSL program under the Commissioner of Higher Education) the role of working with students to find willing private lenders with the guarantee agency providing a 100 percent guarantee in the event of default. The current guarantee rate is approximately 95 to 99 percent.[21]

As of the distribution date of this report, there is not certainty as to the impact that these federal initiatives will have on the national student loan market and what the specific impacts of the potential changes to the program may be on student loans in Montana. Therefore, legislative staff is planning to prepare an update addendum that tracks the emerging developments, both in Montana and nationally, related to the issues discussed in this report.

SUMMARY

Once again, this report is intended to be informational in nature, to clarify the existing situation, to help facilitate the situation going forward, and to allow for LFC discussion, with no action options presented for legislative consideration at this time.

QUESTIONS FOR MHESAC AND SAF OFFICIALS

Given the history, background and issues discussed in this report, LFC members may want to ask MHESAC and SAF officials to respond to the following questions:

1) What is the specific financing vehicle (e.g. auction-rate bonds) and funding availability that MHESAC has in place that allows public statements that "student loan availability for Montana students is secure through academic year 2008-2009"? Is this financing indeed secure through **both semesters** of the 2008-2009 academic year, regardless of auction-rate bond market problems? Why or why not?
2) Are there any concerns about academic year 2008-2009 if student enrollment, and thus student loan demand, were to increase dramatically and unexpectedly, perhaps as a response to an economic slowdown that often drives students to higher education (in particular to two-year institutions)? Why or why not?

3) MHESAC reports a bond debt portfolio for 2000-2007 that includes a mix of 84 percent auction-rate bonds on the tax-exempt side and 26 percent auction-rate bonds on the taxable side, for a total mix of 62.2 percent auction rate bond debt, and an overall outstanding bonds mix of 66.4 percent auction rate bonds. How do these ratios compare to other non-profit student loan corporations similar to MHESAC? Is the MHESAC ratio higher than the industry standard? If so, why is it this high?
4) At what point in time would the continuing bond market problems and the difficulty for bond holders to sell auction-rate bonds create a threat to MHESAC's ability to offer student loans, including primary and secondary market loans? Given that MHESAC represents approximately 75 percent of the overall student loan market, what would be the likely impact on student loan availability for Montana students if MHESAC had to withdraw from the market as occurred with the non-profit student loan corporation in Pennsylvania?
5) If this eventuality does occur such that MHESAC or SAF funding for student loans is decreased, what are the options that the organizations are considering: making fewer loans, limiting loan amounts, etc.?
6) If the financial market problems result in too little funding available for guaranteed student loans in Montana, will Montana students be able to access the federal direct student loan program to meet student loan volume needs? Who has the authority and what is the process for that to occur, for Montana students to have access to the direct loan program through the Montana University System?
7) How does the non-resident student market that MHESAC and SAF finance have an impact upon the Montana student loan availability? Is the financing in the non-Montana market creating any additional threat to the financing for the Montana resident student market? Why or why not?
8) How much additional interest expenditures has MHESAC and SAF experienced in FY 2008 due to the inability of bond holders to sell auction-rate bonds (update from March 2008 data cited above)? How are the organizations absorbing these unanticipated expenditures in the annual budget? What specific staffing and/or operations changes have been implemented to address these expenditure increases and related revenue decreases?
9) Related to organizational structure and accountability, while MHESAC and SAF are private corporations, with MHESAC's creation authorized by the Montana Board of Regents, both exist primarily for a public purpose and benefit (according to their articles of incorporation), so would these organizations object to being held to the same open meetings law standards that state government agencies are held to? Why or why not?
10) In testimony to the legislature in February 1999, MHESAC staff projected that under the plan to restructure and create the SAF "$61.6 million in benefits to Montanans" would be the result, as $36.4 million would be returned to students in the form of rebates of student loan principal and $25 million would be made available, at a rate of at least $1 million per year for grants and other student financial aid programs to students.[22] Could you provide an update on how close MHESAC/SAF has come to meeting that projection in the subsequent nine years?
11) Are there any problems anticipated by MHESAC in purchasing non-Montana consolidation loans that have been warehoused by Montana Student Loan Funding (MSLF), a subsidiary company of SAF? What would be the result if MHESAC did not have sufficient funds available to purchase these warehoused loans? Would this have an impact on student loans for Montana students?

APPENDICES ATTACHED

- Appendix One: HB 578 of the 2007 regular session of the legislature
- Appendix Two: Report and Recommendations to the [Montana] Board of Regents by the Board of Regents Taskforce on Student Loan Issues (March 2008)
- Appendix Three: Letter dated October 15, 2007 from Budget Director David Ewer to State of Montana financial advisor, Piper Jaffray (Mr. P. Jonathan Heroux)
- Appendix Four: Letter dated October 15, 2007 from Piper Jaffray to Budget Director David Ewer
- Appendix Five: Letter dated October 15, 2007 from Budget Director David Ewer to Montana Board of Regents

- Appendix Six: MHESAC document, Overview of Existing Portfolio Purchase Process: Bid Development Process

S:\DOCMGMT\CL5031-Alan\LFC June 2008 Meeting Reports\MHESAC_Report_June_2008_Final_Version.doc
Wednesday, May 21, 2008

Endnotes/References

[1] See http://www.bloomberg.com/apps/news?pid=20601103&sid=awCJRyi5ngcQ&refer=us , accessed on April 21, 2008.

[2] See Montana Board of Regents of Higher Education Policy and Procedures Manual, Policy 505.2, Montana Higher Education Student Assistance Corporation, and 505.4, Non-profit Corporation to Assist and Promote the Montana Guaranteed Student Loan Program (including history).

[3] Montana Higher Education Student Assistance Corporation, Evaluation of Strategic Alternatives (10/28/98) [Revised 11/27/98], O'Neill Company of McLean, VA.

[4] Ibid., pages 39-40.

[5] See Montana Higher Education Student Assistance Corporation website, About Us Quick Facts: http://www.mhesac.org/jsps/about.jsp , accessed on April 21, 2008.

[6] See Student Assistance Foundation website, About SAF Services Provided: http://www.safstudentservices.org/MTLoans/start_corp.jsp?currentMenuName=About%20SAF&content=corp-about-us.jsp , accessed on May 21, 2008.

[7] Ibid.

[8] Third Amended and Restated Articles of Incorporation of Montana Higher Education Student Assistance Corporation, filed with the Montana Secretary of State on March 8, 2005.

[9] Montana Higher Education Student Assistance Corporation (MHESAC), FY 2007 year-end performance report, delivered August 9, 2007.

[10] First Restated Articles of Incorporation of Student Assistance Foundation of Montana, filed with the Montana Secretary of State on September 2, 1999.

[11] Montana Higher Education Student Assistance Corporation, Borrower Benefits Delivered, compilation of MHESAC monthly financing summary reports (illustration received on May 5, 2008). Borrower benefits are itemized as:

- Principal Rebates
- Zero Fee Loans (pay origination and default fees on behalf of the borrower)
- Interest Rate Reductions

[12] SAF Public Purpose Benefits Delivered for Higher Ed, compilation of SAF internal financial statement detail (illustration received on May 21, 2008). Public purpose benefits are itemized as:

- Sponsorships
- Grants
- Program Outreach

[13] Montana Higher Education Student Assistance Corporation, Debt Issuance History, illustration received on May 5, 2008. This document lists the **taxable bond debt issuance** history as follows:

- 2000 = $11.2 million
- 2001 = $29.5 million
- 2002 = $10.3 million
- 2003 = $13.3 million
- 2004 = $0

- 2005 = $252.6 million
- 2006 = $331.5 million
- 2007 = $0
- TOTAL = $648.4 million

[14] Montana Higher Education Student Assistance Corporation, Executive Summary of Financial Statements, for the year ended June 30, 2007.

[15] Ibid, page 2 of 4.

[16] MHESAC staff and board discussed that the tax-exempt status of MHESAC would make this loan portfolio attractive for a non-profit corporation while it would not be as fiscally advantageous for Sallie Mae, a for-profit corporation.

[17] MHESAC Bond Costs in Excess of "Normal" Rates, Auction Bonds July 1, 2007 – March 31, 2008, an analysis provided to the MHESAC Board of Directors on April 8, 2008.

[18] Montana Higher Education Student Assistance Corporation, Debt Issuance History, op cit.

[19] Montana Higher Education Student Assistance Corporation Bonds Outstanding as of April 30, 2008 (report received May 21, 2008).

[20] SAF Implements Cost Reduction Strategy, April 24, 2008, press release by SAF, listing Carolynn Bright, Media Relations Coordinator, as the contact.

[21] Spellings Sees Administration as Still Sorting Out Its Authority on Lender-of-Last-Resort Issue, Chronicle of Higher Education, April 14, 2007.

[22] Testimony of Jim Stipcich to legislative committee on February 11, 1999; Montana Higher Education Student Assistance Corporation: Key Points.

I:\Legislative_Fiscal_Division\LFD_Finance_Committee\LFC_Reports\2008\June\MHESAC_Report.doc

HOUSE BILL NO. 578

INTRODUCED BY J. MUSGROVE

A BILL FOR AN ACT ENTITLED: "AN ACT REVISING THE LAWS GOVERNING THE MONTANA UNIFIED VOLUME CAP BOND ALLOCATION PLAN ACT; REVISING THE DEFINITION OF "STATE ISSUER"; INCREASING THE CHARGE FOR FUNDING AUDITS; PROVIDING THAT A STATE ISSUER IS SUBJECT TO THE PUBLIC PARTICIPATION AND RIGHT TO KNOW STATUTES; CLARIFYING THE ACCESS OF THE LEGISLATIVE AUDITOR TO FINANCIAL RECORDS OF STATE ISSUERS; AMENDING SECTIONS 17-5-1302, 17-5-1312, AND 17-5-2201, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 17-5-1302, MCA, is amended to read:

"17-5-1302. Definitions. As used in this part, unless the context clearly requires otherwise, the following definitions apply:

(1) "Allocation" means an allocation of a part of the state's volume cap to an issuer pursuant to this part.

(2) "Board" means the board of examiners.

(3) "Bonds" means bonds, notes, or other interest-bearing obligations of an issuer.

(4) "Cap bonds" means those private activity bonds and that portion of governmental bonds for which a part of the volume cap is required to be allocated pursuant to the tax act.

(5) "Department" means the department of administration.

(6) "Governmental bonds" means bonds other than private activity bonds.

(7) "Issuer" means a state issuer or local issuer.

(8) "Local issuer" means a city, town, county, or other political subdivision of the state authorized to issue private activity bonds or governmental bonds.

(9) "Local portion" means that portion of the state's volume cap reserved for local issuers.

(10) "Montana board of housing" (MBH) means the board created in 2-15-1814.

(11) "Montana board of investments" (MBI) means the board provided for in 2-15-1808.

(12) "Montana facility finance authority" (MFFA) means the authority provided for in 2-15-1815.

(13) "Montana higher education student assistance corporation" (MHESAC) means the nonprofit

corporation established to provide student loan capital to the student loan program established by the board of regents of higher education under Title 20, chapter 26, part 11.

(14) "Private activity bonds" (PABs) has the meaning prescribed under section 141 of the Internal Revenue Code.

(15) "State issuer" means the state and any agency of the state authorized to issue private activity bonds. For this part only, the Montana higher education student assistance corporation and any subsidiaries of, affiliates of, or other entity that manages or services Montana higher education student assistance corporation contracts related to bonds issued under this part ~~is~~ are considered an agency of the state.

(16) "State portion" means that portion of the state's volume cap reserved for state issuers.

(17) "State's volume cap" means that amount of the volume cap specified by the department pursuant to 17-5-1311(2).

(18) "Tax act" means the latest limitation enacted by the United States congress on the amount of cap bonds that may be issued by a state or local issuer.

(19) "Volume cap" means, with respect to each calendar year, the principal amount of cap bonds that may be issued in the state in a calendar year as determined under the provisions of the tax act."

Section 2. Section 17-5-1312, MCA, is amended to read:

"17-5-1312. Allocation to state issuers – governance of state issuers. (1) Except as provided in subsection (5), the state portion must be allocated to state issuers pursuant to 17-5-1316.

(2) As a condition of receiving an allocation, each state issuer:

(a) shall fully comply with the provisions of Title 2, chapter 3, in all proceedings; and

(b) upon issuance of the bonds, shall pay ~~30~~ 35 cents per thousand of bonds to be deposited in the state general fund for the purpose of funding a portion of the comprehensive annual financial report audit. The legislative auditor has full access to the financial records of any state issuer.

(3) The following set-aside percentages of the state's volume cap must be made in each calendar year for the following state issuers:

State Issuer	Percentage
Board	4
MBH	41
MBI	25

Public Participation in Govt
– Open Meetings Law

– "public participation and right to know"

MHESAC	26
MFFA	4
Total	100%

(4) Each set-aside expires on the first Monday in September.

(5) Prior to the set-aside expiration date, allocations may be made by the department to each state issuer only from its respective set-aside pursuant to 17-5-1316 and a state issuer is not entitled to an allocation except from its set-aside unless otherwise provided by the governor.

(6) After the expiration date, the amount of the set-aside remaining unallocated is available for allocation by the department to issuers pursuant to 17-5-1316 without preference or priority."

Section 3. Section 17-5-2201, MCA, is amended to read:

"17-5-2201. Fee for issuance of bonds. Except for issuers of general obligation bonds ~~which~~ that are payable solely by general fund ~~revenues~~ revenue, each state bond issuer shall, upon issuance of the bonds, pay ~~30~~ 35 cents per thousand of bonds to be deposited in the state general fund for the purpose of funding a portion of the comprehensive annual financial report audit."

NEW SECTION. **Section 4. Effective date.** [This act] is effective on passage and approval.

- END -

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill #	HB0578	**Title:**	Revise bonding authority and volume cap
Primary Sponsor:	Musgrove, John L	**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☐ Technical Concerns
- ☐ Included in the Executive Budget
- ☐ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
Revenue:				
General Fund	$18,798	$18,798	$18,798	$18,798
Net Impact-General Fund Balance	$18,798	$18,798	$18,798	$18,798

Description of Fiscal Impact:
HB 578 revises the state's bonding authority, volume cap, definition of state issuer, and increases the charge for funding audits, provides that state issuers are subject to public participation and right to know statutes, and clarifies access of the Legislative Auditor to the financial records of state issuers.

FISCAL ANALYSIS

Assumptions:
Department of Administration (DoA)
1. The three year average of bond issuance fees for FY 2004, FY 2005, and FY 2006 is $112,768.
2. An increase from 30 cents per thousand to 35 cents per thousand is a 16.67% increase.
3. Applying the 16.67% increase to the three year average results in a general fund revenue increase of $18,798 each year, assuming the level of debt issuance remains constant.

Office of the Commissioner of Higher Education (OCHE)
4. The definition of state issuer has been expanded to include any subsidiaries of, affiliates of, or other entity that manages or services Montana Higher Education Student Assistance Corporation (MHESAC) contracts related to bonds issued under this part.
5. Section 2 of the bill would require state issuers to comply with the public participation and right to know in government operations.

6. The fiscal impact to the OCHE is unknown but it is reasonable to expect that there will be additional costs associated with managing contracts that require private entities doing business with the state to comply with the provisions of Title 2, chapter3, in all proceedings.

Department of Commerce (DOC)

7. The Facility Finance Authority (FFA) issues private activity bonds. The increased audit fees proposed in HB 578 would be assessed to and paid by the borrowers (private entities) through the costs of issuance. The cost would increase the total cost of borrowing. The FFA currently can issue $250 million of bonds per biennium. Under HB 578 that would generate $87,500 in audit fees (250,000 * .35 cents = $87,500) which represents an additional cost of $12,500 per biennium.
8. Increased audit fees proposed in HB 578, along with other cost of issuance fees are paid by the trustee for the bonds and are a part of each bond issue. These fees are not a budgeted line item for state budgeting purposes so the increased audit fees would not have a fiscal impact on the Board of Housing. HB 578 does have an effect on the cost of each bond issue but it is anticipated this increase would be minimal. For example, if new bonds were issued for $200 million the additional audit fee would be $10,000.
9. Private activity bonds issued by the Board of Investments BOI would be affected by HB 578, however the BOI acts as the conduit issuer for these types of bonds and any and all costs incurred, including the required state audit fee, are paid by the borrower (private entity). Therefore this bill would not have a fiscal impact on BOI. The last time BOI issued private activity bonds was in 2002. BOI also issues bonds for the INTERCAP Program and the Qualified Zone Academy Bond Program. Costs of issuing these bonds are also paid by the borrowers. BOI will be issuing $15 million for its INTERCAP Program in March 2007. The additional audit fee for a $15 million bond issue would be $750.

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Fiscal Impact:				
DOA				
Revenues:				
General Fund (01)	$18,798	$18,798	$18,798	$18,798
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$18,798	$18,798	$18,798	$18,798

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*

ITEM 138-110-R0308 Recommendations

Report and Recommendations to Board of Regents

Board of Regents Taskforce on Student Loan Issues

March, 2008

I. Purpose and Membership of Student Loan Taskforce

Questions raised at the October 16, 2007 Board of Regents (BOR) meeting regarding the relationship between the Montana Higher Education Student Assistance Corporation (MHESAC) and the BOR resulted in the appointment of a Regents' Student Loan Taskforce to evaluate Montana student loan industry relationships. Taskforce members are Regent Stephen Barrett, Chair, Regent Todd Buchanan, Commissioner of Higher Education Sheila M. Stearns, Student Assistance Foundation (SAF) President Jim Stipcich, and Montana Office of Budget and Program Planning Director David Ewer.

BOR Chairman Lynn Morrison-Hamilton charged the taskforce to make recommendations to the regents regarding: (1) MHESAC governance and accountability issues relative to MHESAC bond activity; (2) a process for monitoring and making policy adjustments relative to changes in student loan programs and financing issues at the federal level, in accordance with revised federal laws and the Montana Attorney General's report on student loans; and (3) improvements in communications between the regents, the Montana executive and legislative branches, and the SAF and MHESAC boards of directors.

The Taskforce noted BOR Policy 505.4, which allows MHESAC, acting as a non-profit corporation, to provide a secondary market for student loan and loan origination activity.

II. Taskforce Recommendations

The Taskforce met on November 7, 2007, November 30, 2007 and February 13, 2008. Numerous issues and options were discussed. Following are the report and recommendations of the Taskforce. It should be understood that many of these recommendations would benefit from continued discussion among the regents at later board meetings. As is clear from the report, it is expected that the Board of Regents will be more involved and informed in the future about financial aid matters, including matters involving the activities of MHESAC and SAF.

A. Accountability:

The Taskforce recommends that the BOR expand its oversight of student financial aid and student loan issues in the following ways:

1. Ensure consistent review, analysis and oversight by making student financial aid issues part of the regents' Administrative, Budget, & Audit Committee agenda for attention at every BOR meeting. *Being Implemented.*

2. Adopt appropriate policies on program issues like lender lists and lender relationships with schools. *Being Implemented.*

3. Annually review capital availability for both Federal Family Education loan Program (FFELP) and private loans for Montana students.

4. Annually review the level of public benefits for Montana students provided by MHESAC, SAF and other student loan industry participants.

5. Receive annual business overview reports from MHESAC and other significant Montana student loan lenders.

6. Provide input annually on MHESAC's financing and business plans;

7. Support financing efforts to provide sufficient capital to allow Montana students to finance their education as is necessary.

8. As a guarantor of loans made under the FFELP Program and the agency charged with oversight of lender and school participation in FFELP): (1) exercise that oversight responsibility and (2) utilize the statutory Student Loan Advisory Council, to the extent allowed by law, to advise the board on policies related to the FFELP Program and to monitor the FFELP Program.

9. Given the importance of the MHESAC mission and the close relationship between the regents and MHESAC, the Commissioner of Higher Education (CHE) continue as the president of MHESAC and a CHE staff member continue as vice-president. This is authorized by BOR Policy 505.2.

10. MHESAC be requested to adopt the following process: "Future financing issuance activity will require a signed written certification from the Chairman of the Board of Regents that: (1) a communication of intent about the financing was provided by MHESAC to the BOR, the Governor's Office, and the members of CFAC prior to the MHESAC board's meeting at which the issuance of such financing was approved; (2) a properly noticed, public meeting was held to discuss the financing; (3) the financing was approved at a properly noticed, public MHESAC board meeting; (4) the BOR, Governor's Office and CFAC have been notified of the MHESAC approval of the impending financing; and (5) the president or vice-president of MHESAC has expressly approved the transaction."

11. MHESAC be requested to limit its *pre-October 1* national student loan activity to growth rate levels that are acceptable to its finance and credit providers and the rating agencies and that can be accomplished at economic return levels that justify the additional risk of MHESAC issuing bonds to support its non-Montana activity.

12. MHESAC be requested to limit its *post-October 1* national student loan activity to growth rate levels that are acceptable to its finance and credit providers and the rating agencies and that can be accomplished at economic return levels that justify the additional risk of MHESAC issuing bonds to support its non-Montana activity.

13. MHESAC be requested to limit its overall level of taxable-financed loans to levels that do not have a negative impact on its ability to provide tax-exempt funding for Montana loans.

14. MHESAC be requested to evaluate the merits of creation of a for-profit entity removed from MHESAC and the State of Montana toperform non-Montana student loan services currently performed by MHESAC and SAF.

B. Governance:

The Taskforce expressed general support for MHESAC's role and purpose and recognized that it is not an inherent conflict of interest for regents to serve on the board of directors of MHESAC. The Taskforce considered a number of MHESAC and SAF board appointment changes and makes the following recommendations:

1. Regents continue to serve on the MHESAC board.

2. The level of regent participation on the MHESAC board continue at three voting members.

3. The BOR chair continue to appoint the members of the board of directors of MHESAC, including the 3 regent members, in accordance with the current MHESAC Articles of Incorporation.

4. The BOR recommend that MHESAC continue its practice of having the CHE serve as an ex-officio non-voting member of MHESAC's board and as president of MHESAC.

5. The BOR recommend that the MHESAC board member selection process for the non-regent members involve a MHESAC nominating committee that provides a slate of qualified candidates for the appointing authority's use. *Being Implemented.*

6. The BOR recommend that a student member on the MHESAC board be retained but be selected from nominations provided by a designated Montana student organization in lieu of appointment of the student regent.

C. Volume Cap:

The Taskforce recognized that use of volume cap to acquire Montana student loans is an appropriate and beneficial use of that resource and concluded that MHESAC needs stability and predictability with regard to Montana volume cap. Recommendations:

1. The BOR request that MHESAC continue working with the Board of Housing and the Governor's Office collaboratively to (1) allocate scarce resources fairly and (2) comply with all guidelines for requesting volume cap.

2. Since Montana's volume cap is a scarce resource, the BOR request that MHESAC work with the executive branch and other users of volume cap to develop a plan for updating the allocation of available volume cap and an overall review of Montana volume cap laws.

3. The BOR work cooperatively with MHESAC and the executive branch and other users of Montana volume cap concerning the allocation of available volume cap to ensure adequate volume cap for Montana's student loan programs.

4. The BOR work in concert with MHESAC to effect an increase in the amount of volume cap available in Montana by approaching and discussing the issue with the Montana congressional delegation.

5. The BOR and MHESAC jointly request the following of CFAC:

   A. To provide recommendations on "conduct and reporting" expectations of Montana volume cap users.

   B. To serve as the active repository for information sharing on all "state issuers" bonding plans.

6. MHESAC be requested to work with the executive branch and other users of volume cap to develop a plan for updating the allocation of available volume cap.

7. MHESAC and the BOR work with the executive branch to expand the membership of the CFAC to include a representative of MHESAC.

D. Communications:

1. The Governor, the CHE and the MHESAC board designate a person with responsibility for communications on student loan matters.

2. The BOR discuss student financial aid issues as part of the standing agenda of the Administration, Budget & Audit Committee of the BOR. *Being implemented.*

3. The BOR explore the need for, and potential SAF funding for, a position in the CHE's office with responsibility to follow and understand the student loan industry in general and MHESAC's and MGSLP's businesses in particular, for the purpose of providing guidance and counsel to the CHE.

E. Communication of Risk Management:

1. The BOR request a current report from MHESAC on the steps it takes to manage the risks involved in MHESAC's business.

2. The BOR request that MHESAC report at least annually to the BOR and the Governor's Office on the risks associated with its business and the steps it is undertaking to manage such risks.

F. Conflict of Interest:

Montana law prohibits personal and financial conflicts of interest by persons acting in the public interest. There is no inherent illegality or impropriety in regents sitting on the boards of directors of MHESAC or SAF where there is no personal or financial interest which conflicts with that service. Recommendations:

1. Regents continue to serve on the boards of directors of MHESAC and SAF. Concerns about conflicting fiduciary responsibilities to more than one board may be managed through board orientation and written guidelines, as necessary.

2. To satisfy recommendations of the Montana Attorney General regarding the *appearance* of perceived conflicts of interest due to overlapping membership by members on student loan boards, and to alleviate the workload of regents, the BOR consider whether it would be beneficial to ask the SAF board to consider limiting the number of regent members serving on the SAF board to one or two.

3. The BOR recommend that MHESAC and SAF adopt as policy their practice of fully complying with Montana's conflict of interest law.

G. Transparency:

The Taskforce noted that MHESAC follows open meeting and public participation procedures that provide transparency and the opportunity for public participation. MHESAC makes its board meeting summaries available to the public. MHESAC provides public notice of its board meetings and uses its website to inform the public and interested government agencies of information related to its program, including its annual report, annual audits and tax returns. These recommenda-tions, including Recommendation #10 under Accountability, would provide clear incentive for the MHESAC board to follow its public participation policies. Despite these measures, two

members of the Taskforce believe that state law should require MHESAC to comply with the open meeting law.

1. MHESAC be requested to provide annual business overview reports to the BOR and the Governor's Office.

2. MHESAC be requested to communicate with the members of the Legislature concerning its services to Montana citizens.

3. MHESAC be requested to inform CFAC, the BOR and the Governor of its financing plans including plans for both taxable and non-taxable issuances.

4. MHESAC be requested to continue to make its program and operation reviews and audits, audited financial statements, tax returns, offering documents and continuing disclosure statements available to the Legislative Auditor.

5. MHESAC be requested to continue to operate in as open a manner as possible and encourage public participation.

H. Other student and lender issues:

1. Federal student aid programs:

Changes to the federal Higher Education Act, effective October 1, 2007, which affect the Federal Family Education Loan Program (FFELP) and new federal regulations, effective July 1, 2008, which address lender practices, are being reviewed and analyzed by GSL and the Commissioner's Office. Resulting changes to policy and procedure are expected to be in place before the July 1 deadline. The Board of Regents will be apprised of these changes and will be slated to act on any matters requiring board action.

2. Attorney General Recommendations:

Recommendation 1: Conflict of Interest

AG Report: Although the blatant conflicts of interest occurring elsewhere were not found in Montana, the potential for conflict is quite high due to these close and sometimes overlapping relationships. To avoid any potential for or appearance of conflict of interest, Montana's institutions of higher education need to build appropriate safeguards into the school loan system.

Response: This issue is addressed in Section 4, Conflict of Interest. The FFELP Program is subject to federal law, which does not prohibit the board governance structures found in Montana. Conflicts of interest among lenders and educational institutions are addressed in federal regulations and the Montana Guaranteed Student

Loan Program and Commissioner of Higher Education, as the FFELP Program Administrator, monitor program participants for compliance on an on-going basis.

Recommendation 2: Preferred Lender Lists

AG Report: We recommend that each institution of higher education develop comprehensive guidelines explaining the criteria used to select lenders for inclusion on or removal from its preferred lender lists, as well as a clear, well-publicized disclosure that students can borrow from lenders who are not on the list.

Response: The campuses are developing guidelines governing preferred lender lists and taking steps to ensure disclosure to students that they may obtain student loans from lenders who are not on the list. The requirements for a school to use preferred lender lists are detailed in federal regulations and the Commissioner of Higher Education monitors compliance with these regulations.

IV. Conclusion

This report represents the work of the Student Loan Taskforce appointed last October. Many options for better communications, increased accountability and better checks and balances in the student loan industry were identified and discussed in the course of the past four months and the discussions were, in my opinion, useful and productive. I believe the recommendations contained in this report are the best and most workable of the options considered. It is my understanding that the other members of the Taskforce are satisfied with these recommendations. I recommend acceptance of the report and recommendations by the Board of Regents.

Submitted February 22, 2008 by Regent Stephen Barrett, Taskforce Chair.

OFFICE OF THE GOVERNOR
BUDGET AND PROGRAM PLANNING
STATE OF MONTANA

BRIAN SCHWEITZER
GOVERNOR

Student Loans in Montana
Report to LFC
Appendix Three

October 10, 2007

P. Jonathan Heroux, Managing Director
Piper Jaffray – Public Finance Group
1200 17th Street, Suite 1250
Denver, CO 80202

Dear Jonathan:

In your position as the lead representative of Piper Jaffray, financial advisor to the State of Montana, my office requests your opinion regarding several matters involving debt issued by the Montana Higher Education Student Assistance Corporation (MHESAC).

MHESAC is Montana's only issuer of student loan bonds and is exclusively entitled under Montana law to use private activity volume cap for federal tax-exempt bond purposes.[1] Under state statute, when issuing volume cap bonds, MHESAC is an agency of the state.[2] In addition, MHESAC is an entity whose board members are chosen by the Chair of the Montana Board of Regents and many regents serve on the MHESAC board. The Commissioner of Higher Education serves as an *ex-officio*, non-voting board member and President of MHESAC. The student regent also serves *ex officio*.[3]

Over many decades, MHESAC has issued hundreds of millions of dollars of federal and state tax exempt bonds to purchase *Montana student loans*. The cost of these bonds is being subsidized by the taxpayers, but because the bond proceeds directly benefit Montana students, that may be viewed as entirely appropriate.

---

[1] Articles of Incorporation of MHESAC (3rd amended and restated), Article III: "The Corporation is organized and operated exclusively for the benefit of, to perform charitable and educational functions related to, and to carry out charitable and educational purposes of, the state of Montana and the Board of Regents of the Montana University System, an agency of the state of Montana." Exhibit 1.

[2] Mont. Code Ann. 17-5-1302 (15): '"State issuer" means the state and any agency of the state authorized to issue private activity bonds. For this part only, the Montana higher education student assistance corporation is considered an agency of the state.' Exhibit 2.

[3] Articles of Incorporation of MHESAC (3rd amended and restated), Article V: "The Board of Directors shall be composed of seven (7) voting members: (3) Board of Regents Directors and four (4) At Large Directors. The Board of Regents directors shall consist of the student member of the Board of Regents of the Montana University System (the Student Member) who shall serve as an ex-officio, voting member of the Board of Directors"..... "In addition, the Commissioner of Higher Education of the Montana University System shall serve as an ex-officio, non-voting member of the Board of Directors." Exhibit 3.

TELEPHONE: (406) 444-3616 FAX: (406) 444-4670

However, now MHESAC is expanding its role to assist its sister entity, the Student Assistance Foundation (SAF), to purchase *non-Montana student loans financed by the issuance of taxable bonds*.[4] In 2005 and in 2006, MHESAC, without any awareness by this office, issued a total of $554 million in taxable bonds. Just recently, SAF entered into a preliminary agreement with Sallie Mae to purchase up to $900 million in non-Montana student loans, which MHESAC would finance through the issuance of $900 million in taxable bonds.[5]

As Budget Director, I am concerned that these transactions may create risk for the State of Montana. The sheer size of these transactions alone is a basis for my concerns. Further, should any number of possible negative factors arise, I am concerned about unintended consequences, such as, an impact on other state bond issuing agencies or a resulting increase in the state's direct cost of borrowing.

While my view is that any bond activity, regardless of underlying credit structure or payment, could conceivably negatively impact the state, generally, I am satisfied that there is adequate due diligence and administrative oversight with state bonds issued by the executive branch. In contrast, my concerns about MHESAC arise because MHESAC acts outside Montana's open meeting laws and outside oversight by the Legislative Auditor, processes that provide for transparency and public involvement that help guarantee adequate due diligence and administrative oversight in these important financial transactions. Finally, basic questions my office raised about MHESAC and SAF one year ago remain unanswered.

In order for us to properly understand the potential impacts of MHESAC activities on the rest of state government and Montana's taxpayers, would you kindly, as expeditiously as practicable respond to the following questions:

1) Understanding that MHESAC taxable bonds are not backed by the general taxing powers of the state, and are not directly backed by any tax or revenue pledge other than student loans, what is the likelihood that bond holders of MHESAC taxable bonds, in an event of default, would expect or be entitled to any remedy from the State of Montana based on a 'moral obligation,' or any other obligation, even when none has been acknowledged or contemplated?
2) If there is any market expectation of a moral obligation, what would happen if the state failed to implement any remedy for such defaulted bonds?
3) How will the rating agencies, who rate creditworthiness of the state of Montana as a government, view MHESAC's taxable bond issues if they continue on the scale currently being considered? Is it reasonable to anticipate that there would be an effect on the state's ongoing efforts to upgrade its own credit rating, and what is the likelihood of that?

---

[4] MHESAC 5-Year Financial Projections. Exhibit 4.
[5] Email from Jim Stipcich 9/21/07. Exhibit 5.

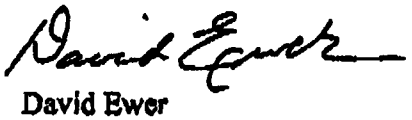
4) Given that the Board of Regents has a central roll in managing its Guaranteed Student Loan Program[6], and that the GSLP is very closely connected to MHESAC's bond issuance activities[7], and that the Board has a statutory role as "guarantor" of loans of money[8], and that MHESAC represents on its offering statement for bond issue that "Eligible loans will be guaranteed (to the extent moneys are available therefore in its guarantee fund) by the Board of Regents....," what consequences are there to the Board of Regents, who also issue bonds, if there is a default or other material market concern with MHESAC's taxable bonds?

5) Is it true that the market penalized the State of Washington for a period of time, i.e., forced the state to pay higher interest rates, as a result of the Washington Public Power Supply System (WPPSS) bond fiasco? I have been told by a bond credit expert that such an interest penalty occurred? *

6) Are you aware of other examples where state or local credit ratings were penalized by the credit difficulties of another related state agency, but whose security pledge to bondholders was explicitly limited only to that agency's pledge, not other agency security or a state general taxation pledge? I have been told that a defaulted school district in California caused a no-bid situation for a city's tax anticipation notes even though there was no legal connection between the two governments.

I welcome any other general thoughts or comments you are able to make along the lines raised by the specific questions above. Your prompt attention to these questions is much appreciated.

Sincerely,



David Ewer
Budget Director

* From June 27 1983 Time article, A failure by WPPSS would severely rattle the $400 billion municipal-bond market by driving down prices and raising borrowing costs for state and local governments. It would be particularly rough on the Pacific Northwest. Says Tim Kerr, deputy treasurer of Washington State: "We will see some very high interest rates."

---

[6] Official Statement, MHESAC, Student Loan Revenue Bonds, Series 2006, D, E, F, G, dated, Oct. 24, 2006: "Eligible Loans will be guaranteed (to the extent moneys are available therefore in its guarantee fund) by the Board of Regents of Higher Education of the State of Montana or other Guarantee Agencies and reinsured by the federal government, all upon terms and conditions summarized herein."

[7] Official Statement, MHESAC, Student Loan Revenue Bonds, Series 2006, D, E, F, G, dated, Oct. 24, 2006:The GSLP Act: "The GSLP Act authorizes the Board of Regents to establish and contract for the operation of a guaranteed student loan program, and designates the Board of Regents as the State representative for receiving federal public or private money available under any federal act or otherwise for purposes of the guaranteed student loan program"

[8] Mont. Code Ann. 20-26-1103:

PiperJaffray.

Suite 1250, 1200 17th Street, Denver, CO 80202
303 820-5848
Piper Jaffray & Co. Since 1895. Member SIPC and NYSE

Student Loans in Montana
Report to LFC
Appendix Four

October 15, 2007

Mr. David Ewer
Budget Director
State of Montana
Capitol Building
P.O. Box 200802
Helena, MT 59620-0802

Re: Letter dated October 10, 2007, regarding Montana Higher Education Student Assistance Corporation (MHESAC)

Dear David,

In order to respond to the questions you posed in your letter to me as financial advisor to the State of Montana, I have performed the following:

- Conferred with one of my colleagues in Denver who worked for Moody's as a rating analyst for nine years prior to joining Piper Jaffray;
- Spoke to several of my institutional sales persons about the MHESAC credit and how the buyers of bonds would react to the various scenarios you inquired about;
- Reviewed several historical events in the bond market;
- Reviewed the Series 2006D-G final offering statement; and
- Reviewed the latest credit report from Moody's concerning MHESAC.

In response to your first question: What is the likelihood that taxable bond holders, in an event of default would expect or be entitled to any remedy from the State of Montana on a "moral obligation" or any other obligation even when none has been acknowledged or contemplated?

Bond holders would legally not be entitled to any form of assistance from the State of Montana because the legal and offering documents regarding the bond issue make it clear that this is not a security that the State supports. However, in the event of a default, I am positive that bond holders would have many questions, including the following:

- How did an event of default happen?
- Why as an agency of the State was there no oversight by the Board of Regents or the legislative auditor as to the bonding activities of MHESAC?

- Why is an agency of the State outside the Montana open meeting law requirement?
- Why does the State of Montana feel no "moral obligation" for a State agency in default?

In response to your second question: If there is any market expectation of a moral obligation what would happen if the State failed to implement any remedy for such defaulted bonds?

I believe that "if" the bond market believed the state of Montana had a "moral obligation" and did not "step up" to help cure the problem, that the State's general obligation credit could be impacted in terms of a higher cost of borrowing in the future.

In response to your third question: How will the credit agencies, who rate the State's credit worthiness, view MHESAC's taxable bond issues if they continue on the scale currently being considered? Is it reasonable to anticipate that there would be an effect on the State's ongoing efforts to upgrade its own credit rating and what is the likelihood of that?

MHESAC's credit is rated by the structured rating group within each rating agency, where as the State's general obligation rating is reviewed in another separate department within the same agency. Due to this fact and the different credit being pledged for each issue in question, I do not believe there would be a "crossing of the credits" meaning they would be looked at separately and independently.

In response to your fourth question: Given the Board of Regents' central role in managing the Guaranteed Student Loan program and that the GSLP is closely connected to MHESAC's bond issuance activities and that the Board has a statutory role as "guarantor" of the loans of money and that MHESAC represents in its offering statements for bonds that "eligible" loans will be guaranteed (to the extent moneys are available in its guarantee fund) by the Board of Regents, what consequences are there to the Board of Regents, who also issue bonds, if there is a default or other material market concern with MHESAC's taxable bonds?

Since the State's and MHESAC's debt issuances are reviewed and rated on the strength of their own merits, legal provisions and credit factors, the consequences to the Board of Regents would be limited legally. However the negative press for the Board of Regents being associated with a default could impact their marketing efforts with new borrowers.

In response to your fifth question: Is it true that the market penalized the State of Washington for a period of time, forced the State to pay higher interest rates, as a result of the Washington Public Power Supply System (WPPSS) bond fiasco. I have been told by a credit expert that such an interest penalty occurred?

I have been told that this was the case and have read several articles where different municipal bond market participants stated that this is what happened. Due to the fact that the event occurred in the early 1980's there is not a lot historical evidence available.

In response to your sixth question: Are you aware of other examples where state or local credit ratings were penalized by the credit difficulties of another related state agency, but whose security pledge to bondholders was explicitly limited to that agency's pledge, not other agency security or a state general taxation pledge?

I can share a recent event in Colorado where the cost of borrowing (for all communities who wanted to offer similar securities) was impacted by one community's actions. In the late 1990's a small town in northern Colorado (Sheridan) did not annually appropriate a debt-service payment on a certificate of participation transaction that financed the Town's city hall. A certificate of participation is an annually renewable lease structure commonly used in Colorado as a means of financing buildings. As a result of this event (by the town), the majority of other municipal issuers in Colorado were forced to pay subsequently higher interest rates when offering similar certificates to the market place for their community capital projects for a period of close to three years. So while there was no connection between the credit being pledged (or association, like another State agency) by one community of Colorado, the entire state was forced to pay a penalty in terms of higher interest costs.

In my opinion, every agency of any state needs to be cognizant of the fact their operations can have an impact on other state agencies. While one state agency may be able to explain that there is no "credit connection" between itself and another agency, the institutional buyer of both tax-exempt and taxable bonds will be very thorough in its due diligence before purchasing any securities, and will uncover any problems or concerns about the specific credit in question as well as other concerns they may have about these other state agencies.

In summary, the rating agencies like to see and often comment, "that from a good public policy standpoint" every state agency should have some form of oversight whether it be legislative or some other form, be subject to open and public meetings and have transparency when it comes to the specific activities of the agency. It is through these means that potential problems can be avoided, or at least limited.

I hope my responses are deemed helpful and responsive to your questions. Please feel free to call me if you have additional questions regarding this matter.

Sincerely,

P. Jonathan Heroux
Managing Director
Public Finance

OFFICE OF THE GOVERNOR
BUDGET AND PROGRAM PLANNING
STATE OF MONTANA

BRIAN SCHWEITZER
GOVERNOR

CAPITOL BUILDING - P.O. BOX 200802
HELENA, MONTANA 59620-0802

Student Loans In Montana
Report to LFC
Appendix Five

October 15, 2007

Lila Taylor
Montana Board of Regents
P.O. Box 595, Route Kirby
Busby, MT 59016

Dear Regent Taylor:

I respectfully request that, as a member of the Board of Regents, you would consider my concerns during your conference call meeting on October 16, when you address matters relating to the Montana Higher Education Student Assistance Corporation (MHESAC) and the Student Assistance Foundation (SAF).

Let me begin by thanking the Board of Regents for calling a conference call meeting and recognizing the importance and timeliness of these issues. My purpose is not to be contentious, but to promote good public policy in an area as important as Montana students.

It was this time last year that I expressed concerns with MHESAC/SAF over the oversight and accountability of these two organizations in what is essentially a public function, reducing student loan costs through taxpayer subsidies. Much has transpired since then, so it is appropriate that we try to establish a common ground to move forward.

First, let me acknowledge that the Schweitzer Administration adheres to a number of guiding principles:

- SAF must stand for "Students Are First", and Montana students' interests must guide our deliberations and actions;
- accountability is an inherent responsibility of governmental processes, especially those involving money;
- transparency, openness and, participation should permeate our processes;
- a team environment serves the best interests of the citizens because the decisions of one part of state government can impact other parts of the people's government;
- proper risk management is an essential element when handling funds in the public arena.

TELEPHONE: (406) 444 3616 FAX: (406) 444 4670

Regrettably, I believe that MHESAC and SAF are not conducting themselves sufficiently within these principles. My concerns, which I hope we can address on the conference call meeting, include:

- lack of accountability to the public;
- possible financial risk to the Montana student loan program;
- potential risk to other state bond issues and potential impacts on state borrowing costs;
- lack of openness in processes and procedures;
- ambiguity in the role of board members as affirmed by the Attorney General;
- perceived and/or real conflicts of interests for Board of Regents members as recognized by Cathy Swift in the conclusion of her 10/10/07 memo;
- contrary to the opinion of MHESAC attorneys, our continuing belief that MHESAC performs ***public functions*** for Montana and for the Board of Regents;
- uncertainty about the impacts of the new governing laws just passed by Congress; and
- questions about whether Montana students are the top priority, as opposed to the apparent primacy of rapid growth in the non-Montana business of the organizations.

The recent effort of SAF to buy $900 million in non-Montana student loans from Sallie Mae and to have MHESAC finance this purchase in taxable bonds prompts this letter. It is my understanding that the full Board of Regents, which established MHESAC and has a vital interest in Montana student loans, was unaware of this financial transaction. The Governor's office was unaware of this transaction until September 21, 2007, when it received an email stating that SAF had ***successfully*** bid on $900 million in student loans sold by Sallie Mae and that permanent financing through bonds would be planned for next spring. Inadequate notice and the lack of communication are, just by themselves, signs of insufficient diligence as opposed to the due diligence that complicated financings require.

I have also learned from a document recently provided to me that, although three of the seven members of the MHESAC board are Board of Regents members and the Commissioner of Higher Education serves as President and ex-officio non-voting member of the MHESAC board, MHESAC requires that its board members, including regents, "must devote their total loyalty to MHESAC when acting as MHESAC directors" (please see the memorandum dated 11/14/2006 from Commissioner Sheila Sterns and president of MHESAC to Bill Thomas, member of MHESAC subcommittee and Fred Flanders, president [*sic*; actually chairman of MHESAC].

I believe that MHESAC has a responsibility to consider not only the impacts of its businesses decisions upon itself, but to other state bond issuers and the state's own credit. I do not believe that MHESAC's bond issues are risk-free to the rest of state government.

I have asked the State's Financial Advisor, Piper Jaffray, to provide an opinion as to the potential impact on other state issuers and state government as a whole. Their response accompanies this letter.

The recent loan purchasing/bond effort with Sallie Mae brings to the forefront the issue of ultimate accountability. Many state entities, including the Board of Regents, issue some type of Montana state bonds, whether general tax, special purpose, limited state liability, or even no direct State recourse. Except for MHESAC, every other state bond issuing entity has its board either appointed by the Governor or consists of, as is the case of the Board of Examiners, elected officials. *MHESAC's continued assertion that it is somehow not accountable to the people of Montana through their government is of great concern.*

Let me stress my desire to proceed on a path of mutual cooperation. I do recommend that the regents put a hold on any further reorganization or any new taxable bond issues until all of these concerns are thoroughly resolved.

Respectfully yours,

David Ewer
Budget Director

C: To all Regents and Ex-Officio Members
Enclosure

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
Overview of Existing Portfolio Purchase Process

BID DEVELOPMENT PROCESS

Contact and Confidentiality

From time to time MHESAC is presented with an opportunity to purchase an existing portfolio of FFELP loans from another lender outside of our current purchase contracts. Typically, the CEO is contacted to determine our interest in the portfolio and the CEO is asked to execute a confidentiality agreement before any information about the sale is disclosed. Upon receipt of the agreement we will receive information on the portfolio up for bid.

Portfolio Evaluation & Financial Viability Determination

The portfolio information may either be detail by individual loan or may be summarized.

When we get the information, we confirm that it matches the summary portfolio information that we received. We then break it down into multiple portfolios based on more specific characteristics such as date of origination, average borrower indebtedness (ABI), remaining life of loan, servicer and borrower benefit type in an attempt to make each sub-portfolio as discrete as possible. We use a portfolio modeling software called DBC that is the gold standard in the student loan business. We load the multiple portfolios, sometimes as many as 100, into DBC and then define the parameters for each of them. Each portfolio is modeled in three primary areas:

1. Loan Characteristics – this includes ABI, remaining life, school type, loan type, borrower interest rate, SAP return, default assumptions, deferment and forbearance assumptions, borrower status, borrower benefits, subsidy status, premium, government payment lag assumptions, prepayment expectations and delinquency expectations.
2. Debt Characteristics – we model an expected case debt assumption. Some of the variables that we look at include debt type (auction, FRN, fixed rate), recycling capability, costs of issuance, redemption schedules, related investment accounts, bondholder payment frequency, rate calculation conventions, senior/subordinate structure, rate index, temporary credit facilities and frequency of rate changes.
3. Expenses – we look at all costs associated with developing a financing, managing and servicing loans such as servicing cost (both on a fixed cost per borrower basis and as basis points relative to portfolio), trustee fee, broker-dealer fee, auction agent fee, lender fees and consolidation rebate fees. We also model in a "cost" for our desired profitability level and then solve for zero.

Once all options are loaded into the system, we run several scenarios for varying premium, expense and profitability levels. We do sensitivity analysis to define what our profitability risks are based on changes in certain variables. Most obvious of these is the qualification rates on borrower benefits.

Business Judgment
At this point, we apply professional judgment to our bid. We take into account such things as whether or not we believe the portfolio can be financed and whether or not we believe it represents a market price. Typically we have our Financial Advisor and our Investment Bankers look at the portfolio as well for a bid price. We then compare our results with theirs for reasonability and then define the bid that we will submit.

Beyond the cashflow modeling, we also take a look at the servicer if it is not SAF. We look at whether or not they were an Exceptional Performer and what their reputation in the industry is. We also look at the economic viability of the servicer. We already use other third-party servicers for small parts of the student loans that we service and have contracts with them for additional servicing. If the servicer is a new servicer, we seek bids for servicing and begin due diligence on that servicer. We also look at which guarantors are guaranteeing the portfolio and insure that we have agreements with them in place.

Once we have completed this analysis our desired purchase price bid and a bid is prepared and submitted. The bid is prepared in concert with legal counsel. Our bid always contains conditions that the bid is subject to. These conditions always indicate that the offer must be confirmed by the MHESAC Board by a certain date. Other conditions that we typically include are a response date by the seller, any loans in claim status are excluded from our bid, representation that if loans delivered differ significantly from the bid detail provided that we reserve the right to renegotiate the price, that satisfactory servicing arrangements can be made and that acceptable financing arrangements can be completed by a particular date.

ONCE A BID IS ACCEPTED

Confirming Portfolio Data Using Loan Specific Info
When a bid is accepted, we immediately request a detailed tape of the loans to be sold. The information requested is loan by loan detail and includes the financial characteristics of the loan (such as balance, borrower interest rate, disbursement date, SAP type, guarantor, principal received, status., delinquency information, etc). This loan by loan data is then reviewed again using DBS to make sure that our view of the portfolio matches the summary info we were provided for structuring the bid.

Servicer Review
If the loans are to be serviced by the existing servicer we complete our due diligence on the servicer and any contact work that must be completed with the servicer. If the loans are to be converted to SAF servicing, test conversions are developed and accomplished.

Legal Review
At this point in time, negotiations commence on a loan purchase contract. Legal counsel is highly engaged in these negotiations and makes sure MHESAC is protected on such items as repurchase rights, and representations about the loans and the corporate status of the seller. We would engage our counsel for lien searches and contract review.

Financing
Management simultaneously completes any necessary work on financing of the portfolio (whether it is warehouse or permanent in nature).

Board Review
Once all items are resolved and management is ready to recommend execution of the transaction the proposal and all details and terms is presented to the Board for their final consideration and action.

After the Board approves the transaction, the acquisition is consummated.

AFTER THE PURCHASE

Post Acquisition Process
Assuming successful consummation of the transaction, we proceed to do a detailed review of each loan file after purchase. The process involves confirmation of a valid debt, review of all due diligence activity done on the loan, review of the promissory note, etc. In the event the loan file detail does not match the tape detail any differences are resolved. Adjustments to purchase price are made as necessary and if differences can not be resolved the loan would be sold back under the repurchase language in the loan purchase contract.