



1200 North Seventh Street, Harrisburg, PA 17102

**Meeting of the Board of Directors
September 20, 2018 – 10:00 AM**

A meeting of the Board of Directors was held on September 20, 2018 at 10:00 a.m. in the Boardroom.

Those in attendance were:

Representative Michael Peifer, Chairman
Senator Ryan Aument
Senator John P. Blake
Representative Mike Carroll
Representative Paul Costa
Representative Sheryl Delozier
Senator John Eichelberger, Jr. **(via teleconference)**
Honorable Roy Reinard
Representative James Roebuck, Jr. **(via teleconference)**
Chancellor Timothy R. Thyreen **(via teleconference)**
Senator Robert M. Tomlinson **(via teleconference)**
James H. Steeley, Interim President and CEO
Jim White, General Counsel

Those absent were:

Senator Wayne D. Fontana, Vice Chairman
Representative Matthew D. Bradford
Senator Arthur Haywood
Representative David Hickernell
Senator Vincent Hughes
Representative Bernie O'Neill
Senator Mario Scavello
Secretary Robin Wiessmann
Secretary of Education Pedro Rivera

Also in attendance:

Liz Craig, Senator Hughes' office; Steph Applegate, Senator Aument's office; Jen Smeltz, Senator Tomlinson's office; Leo Pandeladis, Secretary Wiessmann's office; Patty Smith and Jeff Caldwell, Rock the Capital; Ed Haines, SAS; Jan Murphy, Penn Live; Tom Foley, AICUP; and the following PHEAA staff: Nathan Hench, Keith New, Mubashar Hameed, Todd Mosko, Stephanie Martella, Mike Garman, Judith Bines, Elizabeth McCloud, Bethany Coleman, Amanda Foster, James Jarecki, Kyle Lefever, Andrew Mehalko, Will Lindsey, William Fisher, Lisa Gipe, Dana Hepner and Jodi Shomper

Upon establishing the presence of a quorum, Chairman Peifer called up Agenda Item #1.

1. **Minutes**

On a motion made by Mr. Roy Reinard, seconded by Representative Carroll, the minutes of the June 21, 2018 meeting were unanimously approved.

Chairman Peifer called up Agenda Item #2.

2. **Financial Statements for the Year Ended June 30, 2018 and 2017**

Chairman Peifer called on Mr. Andrew Mehalko, who thanked the Chairman and began with the presentation entitled Management's Report to the Board of Directors. The report is a summary of our results for the year ended June 30, 2017. Mr. Mehalko noted that a draft of the June 30, 2018 year-end financial statements, and Annual Financial report, as well as a Note 10 OPEB & RSI Supplement, were finalized after the draft financial statements were uploaded to BoardEffect. This Note will be included in the published year-end financial statements.

Mr. Mehalko began on Pages 4 and 5 of the presentation to summarize our operating results compared to the June 2017 adopted budget, with Page 5 serving as a visual representation of how our actual consolidated operating performance varied with budget. In this chart, the green bars represent positive changes to operating income and the red bars represent negative changes. Our actual results did not meet the June 2017 budget approved targets – achieving a net operating income of \$21.5 million as compared to the original June 2017 budget of \$31.7 million. The bars between the budgeted income of \$31.7 million on the left and the \$21.5 million on the right represent the variances against budget. The two main drivers of operating income differences were unrestricted revenue missing its target by \$33.9 million, a majority of which was lower retention of collections on defaulted loans due to a decline in loans rehabilitated during the fiscal year; and a partial offset by personnel and benefit costs coming in \$21.1 million lower than the June 2017 budgeted amount, a majority of which was due to lower pension expenses than initially budgeted.

Mr. Mehalko continued to Pages 6, 7 and 8 which presented our operating results for the 2017-18 Fiscal Year compared with the prior year. Page 6 presents our operating income statement in a condensed manner. Mr. Mehalko asked the Members to look at the bold line about 1/3 of the way up from the bottom, and noted our unrestricted operating income declined from \$1.2 million to a net operating loss of \$35.5 million in the current fiscal year, a decline of approximately \$36.8 million. He stated that the importance of the unrestricted operating income is that it is our mechanism to provide supplemental funding to the state grant program without drawing from reserves. PHEAA's restricted operating income, which is predominately the net interest income from our student loan trusts, declined by \$7.5 million from \$64.5 million last fiscal year to \$57.0 million in the current fiscal year. The two drivers of this decline were the runoff of our FFELP student loan portfolio from borrower payments, and rising interest rates and the resulting spread compression. This brings our consolidated operating income to \$21.5 million for the current fiscal year compared to \$65.8 million for the prior fiscal year, a drop in operating income of 67.3%.

Page 7 provides a visual waterfall of the changes in operating income from the prior fiscal year on the left of the chart to the current fiscal year on the right. Mr. Mehalko stated that green again represents positive, while red is negative. He started with the green bar on the left and pointed out that the Members can see our prior fiscal year operating income of \$65.8 million. Moving from left to right, the next bar shows that there was a negative change, or decline, in unrestricted revenue of \$39.4 million. Mr. Mehalko stated that we experienced

declines of \$28.4 million in retention of collections on defaulted loans and \$3 million in Federal Fees under our guaranty line of business, as well as \$7.8 million in servicing fees under our servicing line of business. The fourth bar from the left shows our net interest revenue declined \$20.2 million from the prior fiscal year. There was decline in student loan receivables, of \$438 million for the fiscal year, which negatively impacted our net interest income by \$15 million. The remaining \$5 million decline was due to rising interest rates during the fiscal year. The fifth bar over from the left is a green bar representing a \$12.7 million positive effect from a reduction in eliminations and other expenses, most notably bond issuance costs incurred during fiscal year 2017 that were not incurred this fiscal year. All of these changes are what led to the change in operating income to \$21.5 million for the 2017-18 fiscal year.

Page 8 present PHEAA's rolling 5 year income statement including the 2018-19 projected budget year showing a net consolidated operating loss of \$42.6 million.

Page 9 presents our consolidated balance sheet, which continues in run-off mode, due to the repayment of our FFELP loan portfolio. Total assets declined from \$6.4 billion to \$5.7 billion, a decline of 11.6%. Total liabilities declined from \$5.7 billion to \$5.4 billion, which is only a 6% decline compared to the asset decline of 11.6%. This was due to due to the adoption of GASB 75 - Accounting For Post-employment Benefits Other than Pensions (OPEB) and a \$357.1 million payable as of June 30, 2018. Mr. Mehalko noted that PHEAA's net assets, which are our reserves, declined by \$465.5 million from \$687 million to \$221.5 million as a result. Our unrestricted reserves declined by \$508.1 million from \$263.7 million to a negative \$244.4 million.

Finally, Page 12 presents our public service benefits. For the fiscal year just completed, PHEAA provided direct cash funding to the state grant and other programs of \$103.5 million out of our earnings and reserves. When layering on our costs of running these grant programs at our own expense as well as the outreach activities we perform, our total public service benefit for last year was \$125.1 million. On a rolling 10 year basis, PHEAA has contributed over \$824 million including direct cash funding and the absorption of the costs of running the grant programs and outreach activities.

Mr. Mehalko continued with the annual financial statements. He stated that during yesterday's Audit Review Committee, key areas of accounting and financial reporting judgement were reviewed. There were no significant accounting developments or changes to key estimates from what was reviewed with the Audit Committee in prior quarters with the exception of, as was previously mentioned, PHEAA's adoption of GASB 75 – Accounting and Financial Reporting for Postemployment Benefits Other than Pensions (“OPEB”), which resulted in a reduction of our July 1, 2017 beginning net position of \$382.7 million. E&Y has completed their audit and anticipates providing their clean audit opinion later today. We plan to finalize the statements today and post them to the investor information section of our web sites next week.

Mr. Mehalko completed his report and asked if there were any questions. Chairman Peifer asked if we are expecting a clean audit opinion from E&Y and if all data from the financial side of our business will be located on our website. Mr. Mehalko confirmed that was correct and that the quarterly financial statements are also available on the website. Chairman Peifer thanked Mr. Mehalko and reminded our public guests that they can find and review all of our financial data on our public websites.

Chairman Peifer then called upon Mr. Nathan Hench for Agenda item #3.

3. **2018-2019 Re-budget of Commonwealth Appropriated Programs**

Under Tab 3 of the Board materials is a memo from Mr. Steeley entitled "2018-2019 Re-Budget of Commonwealth Appropriated Programs."

This past summer, the General Assembly and the Governor signed into law the 2018-2019 Commonwealth Budget. The chart on the first page of the memo is an outline comparing the 2017-2018 Appropriations to the final 2018-2019 final budgeted amount by program with the change in difference in the far right column.

You will see that IAG and the PA Internship Program received increases.

Page 2 of the memo shows a second chart that outlines the allocation of the PHEAA public service dividend.

The motion included on Page 4 of the memorandum is for the Board's consideration and effectively recognizes these appropriated amounts and authorizes the Interim President and Chief Executive Officer to administer the programs within the resources allocated.

The following motion was made:

2018-2019 Re-budget of Commonwealth Appropriated Programs September 21, 2017

That the Agency's 2018-2019 program year re-budget allocating appropriated funds and augmentations as set forth above and the administration of the programs as set forth in this memorandum be approved and that the interim President and Chief Executive Officer be given the authority to adjust these augmentations within each program from time to time.

Representative Costa made the motion, seconded by Representative Delozier. All members voted in the affirmative.

Chairman Peifer then called up Agenda item #5.

5. **2019-2020 Commonwealth Appropriation Requests**

Chairman Peifer called on Chancellor Thyreen, who thanked the Chairman and provided a report from the Committee on Need Analysis and Aid Coordination meeting that was held on Monday, September 17. Chancellor Thyreen asked the Board members to turn to Tab 5 of the BoardEffect materials, which is a memo from Mr. Steeley entitled, "2019-2020 Commonwealth Appropriation Requests." Chancellor Thyreen said he would speak to this memo in a moment, but he first wanted to remind the Board about some key factors on how we arrived at the current state. PHEAA has cautioned the General Assembly that our ability to supplement the PA State Grant Program is strictly contingent upon having sufficient financial resources available, which can fluctuate from year to year.

PHEAA has also cautioned that this funding is supplemental - intended to boost the purchasing power of the program. It was never intended to supplant the General Assembly's responsibility to adequately fund the program that they created to benefit their constituents.

Yet, as PHEAA's contributions increased over the years, the Commonwealth's appropriation has decreased, essentially converting the PHEAA supplement into a supplantation. Chancellor Thyreen stated that as the Board will recall, we struggled earlier this year (April 2018 – to be exact) to provide meaningful awards based on level state funding of \$273 million, which was down 33% from \$407 million in 2008-09 and down 21% from \$345 million in 2014-15.

For 2018-19, PHEAA managed to approve a \$101 million supplement to the Commonwealth's \$273 million appropriation. Due to PHEAA's limited resources, this included \$56 million that had been held in reserve for 2019-20. The PHEAA Board, in direct communication with the Governor's office and the four caucuses, decided to pull this money forward to maintain the 2017-18 maximum grant award of \$4,123, with the understanding that we would not have that money to supplement the program next year.

Chancellor Thyreen stated that next year is here, and PHEAA does not have any money to supplement the Commonwealth's appropriation. Without additional funding from the Commonwealth, the 2019-20 maximum award is expected to drop more than \$1,100 to \$3,016. This takes us back to 1999 award levels when the maximum award was \$3,100. Chancellor Thyreen further noted that over a 12-year historical period, there was only one year where the maximum award fell below \$4,000.

Chancellor Thyreen said that the heart of the matter and the Board's discussion today is that total resources needed to maintain the 2018-19 maximum award for 2019-20 is projected to be \$368 million, which is \$95 million more than level funding of \$273 million would provide. He stated that as the Board contemplates what level of funding we will seek from the Commonwealth for 2019-20, he believes we need to be guided by what students actually need – at a minimum – to maintain the level of grant assistance that they received in 2018-19. Chancellor Thyreen said if we don't advocate for them, as PHEAA Board members, then we will fall short on our responsibility to them, just as their grant awards will fall short in helping them afford a higher education.

Chancellor Thyreen then called on Mr. Hench, to provide the Board with a recap of PHEAA's 10-year history of supporting the PA State Grant Program.

Mr. Hench walked through a brief slide deck that provided a historical look at the funding of the program.

Mr. Hench concluded his presentation. Chancellor Thyreen thanked Mr. Hench and turned to Page 2 of Mr. Steele's memo, which shows a chart that outlines the 2017-18 and 2018-19 appropriated amount, as well as the Need Analysis and Aid Coordination Committee's recommended amount for the 2019-20 fiscal year.

Chancellor Thyreen stated that the Committee reviewed and discussed the 2019-20 request amount for the PA State Grant Program. He said not to belabor the point, but the Committee landed on unanimously recommending to the Board that the State Appropriation for the PA State Grant Program be increased from \$273.3 million to \$368.2 million, translating to a 34.7% increase.

Chancellor Thyreen pointed out that below the PA State Grant Appropriation requests is a list of recommended increases for the Special Programs administered by PHEAA, which the

Committee also deliberated. After discussion, the Committee agreed that a general 5% increase request would be prudent for 2019-20. This 5% increase request would be applied to the following programs: Institutional Assistance Grants, Matching Funds, Higher Education for the Disadvantaged (Act 101), Higher Education for Blind or Deaf Students, Ready to Succeed Scholarships, and Pennsylvania Targeted Industry (PA-TIP). The remaining programs that are on the divided chart are those for which PHEAA acts as the disbursing agent, but does not administer. PHEAA, working with our partners, gathered relevant budget requests for these programs.

Chancellor Thyreen stated that if the Board is agreeable, as Chairman of the Need Analysis and Aid Coordination meeting, he would recommend that the Board approve the recommendations made by the Committee. These recommendations are outlined in the ten resolutions that are on Pages 2 and 3 of the memo – the Board could take each resolution individually or collectively in one motion.

Senator Blake asked if the state grant award would be \$1,100 dollars less and if the number of recipients would also be reduced. Mr. Hench answered that the recipient count would be the same for 2018-19, but we would expect the number to decrease to 149,000 next year.

Chairman Peifer asked Mr. Hench to review the Governor's appropriation request process. Mr. Hench said that this is a normal part of the budget process that we do every year to get the wheels rolling. We receive a formal request from the Governor every September regarding what PHEAA's needs are, and our recommendations are due back to the Governor during the first week of October. The Governor's office reviews the transmittal document during the fall and winter and the Governor then informs the General Assembly of his budget proposal.

Mr. Hench then stated that today's action by the Board directs PHEAA management regarding what to formally request, when then goes to the Budget Secretary, who presents it to the Governor and the General Assembly.

Mr. Hench directed the Board to Pages 2 and 3 of Mr. Steeley's memo, which lists each program where funding is being requested, and asked the Board to consider the following 10 motions:

**2019-2020 Commonwealth Appropriation Requests
September 20, 2018**

- (1) *That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request for the 2019-2020 Pennsylvania State Grant Program an appropriation of \$368,233,001.*
- (2) *That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request for the 2019-2020 Institutional Assistance Grants Program an appropriation of \$27,847,000.*
- (3) *That based upon the recommendation of the Board's Committee on Need*

Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request for the 2019-2020 Matching Funds Program an appropriation of \$13,121,000.

- (4) That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request a 2019-2020 appropriation of \$2,358,000 for the Higher Education for the Disadvantaged (Act 101).*
- (5) That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request a 2019-2020 appropriation of \$49,000 for the Higher Education for Blind or Deaf Students.*
- (6) That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request a 2019-2020 appropriation of \$5,250,000 for the Ready to Succeed Scholarships.*
- (7) That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request a 2019-2020 appropriation of \$6,300,000 for the Pennsylvania Targeted Industry Program.*
- (8) That the President and Chief Executive Officer be directed to request an appropriation of \$2,500,000 for the Cheyney University Keystone Academy for 2019-2020 consistent with the recommendation by the Pennsylvania State System of Higher Education.*
- (9) That the President and Chief Executive Office be directed to request an appropriation of \$1,800,000 for the Horace Mann Bond-Leslie Pinckney Hill Scholarship for 2019-2020 consistent with the recommendation by the Pennsylvania Department of Education.*
- (10) That based upon the recommendation of the Board's Committee on Need Analysis and Aid Coordination, the President and Chief Executive Officer be directed to request a 2019-2020 appropriation of \$450,000 for the Pennsylvania Internship Program Grants.*

A motion to accept the resolutions was made by Mr. Reinard, seconded by Representative Carroll, and unanimously approved.

Chairman Peifer then apologized after realizing the Board did not hear the Audit Review Committee and Executive Committee reports, and called up Agenda Item #4. He called on Representative Carroll to read the Audit Review Committee report.

4. Committee Reports

Representative Carroll thanked the Chairman and said that the Audit Review Committee met yesterday afternoon. The first order of business was to adopt the minutes for the meeting held on May 23, 2018.

Management presented the 2017/2018 financial results and Ernst and Young presented their review of PHEAA's financial results, noting that they concurred with Management's Representations, they had no uncorrected misstatements other than the judgmental immaterial difference related to mortality projections, no issues with internal control over financial reporting and that they received great cooperation on the engagement.

Representative Carol said that the Committee's second order of business was to enter Executive Session to discuss internal audit, risk matters and compliance matters.

After the Committee returned to Regular Session, and having no other business, the meeting was adjourned.

Hearing no questions, Chairman Peifer called on Chairman Tomlinson for the Executive Committee Report.

Senator Tomlinson thanked the Chairman and said that the Executive Committee met last evening and after establishing a quorum, the first order of business was to adopt the minutes from the August 27, 2018 meeting. Following the adoption of the minutes, the Committee reviewed a resolution that was presented by Ms. Amanda Foster, Interim Chief Risk Officer. The resolution effectively transferred the Red Flags program from the General Counsel to the Chief Risk Officer. After the Committee reviewed the resolution, it was unanimously adopted.

The Committee then moved into Executive Session to receive a litigation report from PHEAA's General Counsel, to consult with professional advisors and internal auditors regarding PHEAA finances, to discuss a personnel matter, and to discuss Agency business, which if conducted in public, would lead to the disclosure of confidential information that is protected by statute.

Following the return to Regular Session, the Committee immediately adjourned.

Senator Tomlinson concluded his report, and hearing no questions, Chairman Peifer called on Mr. James Steeley for Agenda Item #6.

6. Interim President and Chief Executive Officer's Report

Mr. Steeley thanked the Chairman and called for an Executive Session to consult with professional advisors and internal auditors regarding PHEAA finances and to discuss Agency business, which if conducted in public, would lead to the disclosure of confidential information that is protected by statute.

The Committee then returned to Regular Session to discuss Agenda Items #7 and #8.

7. Entry of Additional Orders of Default

Chairman Peifer called on Mr. Steeley, who reported that there are several orders of default that require Board action. The borrowers outlined on the attached spreadsheet have been notified several times by PHEAA that they need to repay certain obligations to the Agency. In all of these cases, recipients received a grant for college but did not fulfill their obligations for

receiving the grant. Board action is necessary in order for PHEAA staff to continue to attempt to collect on these grants - now converted to loans – as required by the program's statutes.

Mr. Steeley suggested to Chairman Peifer that the Board adopt the attached Resolution in order to authorize PHEAA staff to continue to collect on the loans.

Hearing no questions, Chairman Peifer called for a motion to adopt the Order of Default Resolution, as presented. Representative Costa made the motion, seconded by Representative Carroll, and the Resolution was unanimously adopted and is attached to these minutes.

Chairman Peifer called up Agenda Item #8.

8. **Other Business**

Hearing no other business, Chairman Peifer adjourned the meeting.

**Resolution of the Board of Directors
Pennsylvania Higher Education Assistance Agency
Order of Defaults
Adopted September 20, 2018**

WHEREAS, Act 102 of 1982 authorized an Administrative Loan Collection Process for the Pennsylvania Higher Education Assistance Agency, including use of a Statement of Claim; and

WHEREAS, this legislation provides that the Agency "may initiate action against borrowers whom it deems to be indebted to it by filing a statement of claim in the records maintained by the Agency"; and

WHEREAS, a Statement of Claim has been filed against each of the borrowers whose names appear on the List of Recommended Cases for Entry of an Order of Default dated September 20, 2018; and

WHEREAS, a summary of the Statement of Claim has been served on each such borrower by first-class mail in compliance with the requirements of Act 102; and

WHEREAS, 30 days from the date of service have elapsed and none of these borrowers has filed a response to the Statement of Claim as required by Act 102; and

WHEREAS, the President and Chief Executive Officer has recommended to the Board of Directors of the Agency that an Order of Default against these borrowers be entered by the Board to be lodged in Agency records;

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors of the Pennsylvania Higher Education Assistance Agency enters an Order of Default to be lodged in Agency records against each borrower whose name appears on the List of Recommended Cases for Entry of an Order of Default dated September 20, 2018.