



**THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION**

Financial Statements

March 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

**THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION**

Financial Statements

March 31, 2010 and 2009

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

Board of Trustees
New York State Higher Education
Services Corporation:

We have audited the accompanying financial statements of the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of the New York State Higher Education Services Corporation (HESC), as of and for the years ended March 31, 2010 and 2009, which collectively comprise HESC's basic financial statements as listed in the table of contents. These financial statements are the responsibility of HESC's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HESC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in note 1, the financial statements present only the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC and do not purport to, and do not, present fairly the financial position of the New York State Higher Education Services Corporation as of March 31, 2010 and 2009 and its changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the Guaranteed Student Loan Programs' Operating Fund and Federal Fund of the New York State Higher Education Services Corporation as of March 31, 2010 and 2009, and the respective changes in net assets, and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.



In accordance with *Government Auditing Standards*, we have also issued a report dated, December 29, 2010 on our consideration of the Operating Fund's and Federal Fund's internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 3 through 12 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

December 29, 2010



HESC'S VALUES

- **Our Employees**
We are committed to teamwork, excellence, initiative, personal growth and responsibility.
- **Our Customers**
We never take our customers for granted. We ask, we listen and we respond.
- **Our Products and Services**
We are committed to high quality, dependability, and continuous improvements to meet the changing needs of our customers.

Management's Discussion and Analysis

This section of the New York State Higher Education Services Corporation Guaranteed Student Loan Programs' (HESC) financial statements presents management's discussion and analysis of its operations and financial performance during the fiscal years ended March 31, 2010 and 2009. This analysis provides supplementary information on the operations and activities of HESC, and should be read in conjunction with the Operating and Federal Funds' financial statements, which follow this section.

Organization and Operations

HESC is an agency of New York State (NYS) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of New York State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program.

FFELP was established by Congress and is administered by the U.S. Department of Education (ED) through HESC and other guaranty agencies. As a guaranty agency, HESC makes loans available through lending institutions to students attending colleges, universities, post-secondary educational, and vocational schools. FFELP allows HESC to guarantee repayment of principal and accrued interest to lenders for eligible student loans.

HESC has the responsibility of processing loans submitted for guarantee, issuing loan guarantees, providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs (GSL) include the residual activity of the State guaranteed loan program in which no new loans have been guaranteed since 1984.

HESC has a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund to account for FFELP activity. The Federal Fund assets, and earnings on those assets, are restricted in use and are property of ED. The Operating Fund property of HESC, and its assets and earnings are restricted for guaranty agency and other student financial aid related activities.

New York State Higher Education Services Corporation
Management's Discussion and Analysis (unaudited)
March 31, 2010 and 2009

2010 Financial Highlights-Operating Fund

- Current assets decreased \$4 million or 6%.
- Current liabilities decreased \$1.6 million or 8%.
- Operating revenue decreased \$15.1 million or 14%.
- Operating expenses decreased \$12.4 million or 16%.
- The Operating Fund provided \$11.8 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided \$4.6 million toward the start up costs for the New York Higher Education Loan Program (NYHELPS).
- The Operating Fund provided \$22.2 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.

2009 Financial Highlights-Operating Fund

- Current assets increased \$21 million or 41%.
- Current liabilities decreased \$5.7 million or 22%.
- Operating revenue decreased \$33.4 million or 23%.
- Operating expenses decreased \$11 million or 13%.
- The Operating Fund provided \$12.3 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided \$1.1 million for the cost of administering the GEAR UP program.
- The Operating Fund deposited \$1.3 million into the Federal Fund for the mandatory federal default fee.

New York State Higher Education Services Corporation

Management's Discussion and Analysis (unaudited)

March 31, 2010 and 2009

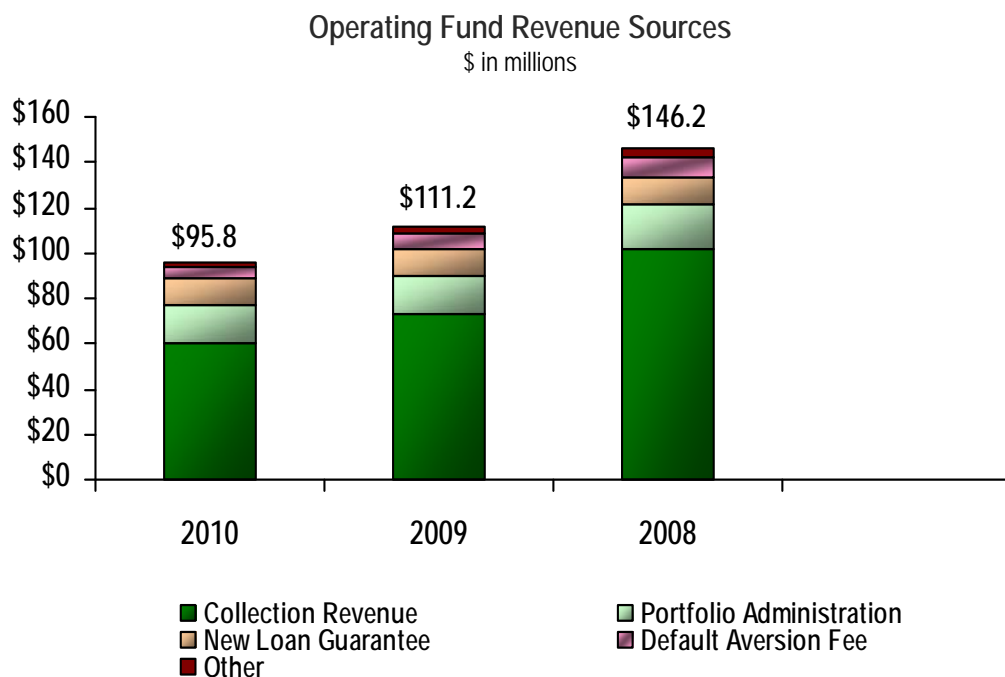
Condensed Financial Information

Amounts in thousands	Operating Fund			Federal Fund		
	2010	2009	2008	2010	2009	2008
Current assets	\$ 68,683	72,721	51,698	94,983	90,335	84,373
Capital assets	203	38	81	—	—	—
Other noncurrent assets	—	—	—	5,263	4,183	3,941
Total assets	68,886	72,759	51,779	100,246	94,518	88,314
Current liabilities	18,770	20,380	26,055	—	423	—
Noncurrent liabilities	5,263	4,183	3,941	10,300	10,300	10,300
Net assets:						
Invested in capital assets	203	38	81	—	—	—
Restricted	44,650	48,158	21,702	89,946	83,795	78,014
Total net assets	\$ 44,853	48,196	21,783	89,946	83,795	78,014

	Operating Fund			Federal Fund		
	2010	2009	2008	2010	2009	2008
Operating revenue:						
Default loan collections	\$ 60,662	73,272	101,876	204,007	207,136	242,674
Reimbursement on defaulted loans	—	—	—	561,625	514,279	472,537
Other	33,285	35,780	40,542	29,952	29,908	4
Non Operating revenues	1,821	2,185	3,778	61	746	2,871
Total revenues	95,768	111,237	146,196	795,645	752,069	718,086
Operating expenses:						
Administrative	64,677	77,116	88,103	—	—	—
Default loan purchases	—	—	—	584,411	534,694	491,519
Collection payments to ED	—	—	—	195,313	199,040	233,822
Fee subsidies	—	—	—	4,984	6,842	9,567
Other	43	43	98	6	—	—
Non Operating expenses	39,171	13,370	22,742	—	6	—
Total expenses	103,891	90,529	110,943	784,714	740,582	734,908
Transfers	4,780	5,705	(22,512)	(4,780)	(5,705)	22,512
Change in net assets	\$ (3,343)	26,413	12,741	6,151	5,782	5,690

New York State Higher Education Services Corporation
 Management's Discussion and Analysis (unaudited)
 March 31, 2010 and 2009

HESC Total Operating Fund Revenue



Operating Fund Revenue Highlights for the fiscal year ending March 31,	
2010	2009
<ul style="list-style-type: none"> • Collection revenue represents 63% of total revenue, a decrease from last year as a result of lender rehabilitation loan discounts. • Portfolio administration revenue decreased by \$0.4 million as a result of a decrease in the principal amount of loans outstanding due to the Federal Loan Purchase Commitment (PUT) program. • HESC guaranteed \$3.4 billion in new loans, a decrease of \$.3 billion in loan volume which resulted in a slight decrease in loan processing revenue. • Default aversion fee (DAF) revenue decreased \$1.9 million to \$5 million primarily as a result of a decrease in DAF revenue and an increase in DAF refunds. 	<ul style="list-style-type: none"> • Collection revenue represents 66% of total revenue, a decrease from last year as a result of the loss of lenders participating in the rehabilitation program. • Portfolio administration revenue decreased by \$3.5 million as a result of a decrease in the Account Maintenance Fee (AMF) rate from .10% to 0.06%, effective 10/1/07. The loss in revenue from the rate change was partially offset by an increase in the loan portfolio balance of 7.8% to \$26.2 billion. • HESC guaranteed \$3.7 billion in new loans, an increase of \$.5 billion in loan volume. • Default aversion fee revenue decreased \$2.8 million to \$6.8 million as a result of an increase in the allowance for DAF refunds, to reflect current trends.

New York State Higher Education Services Corporation

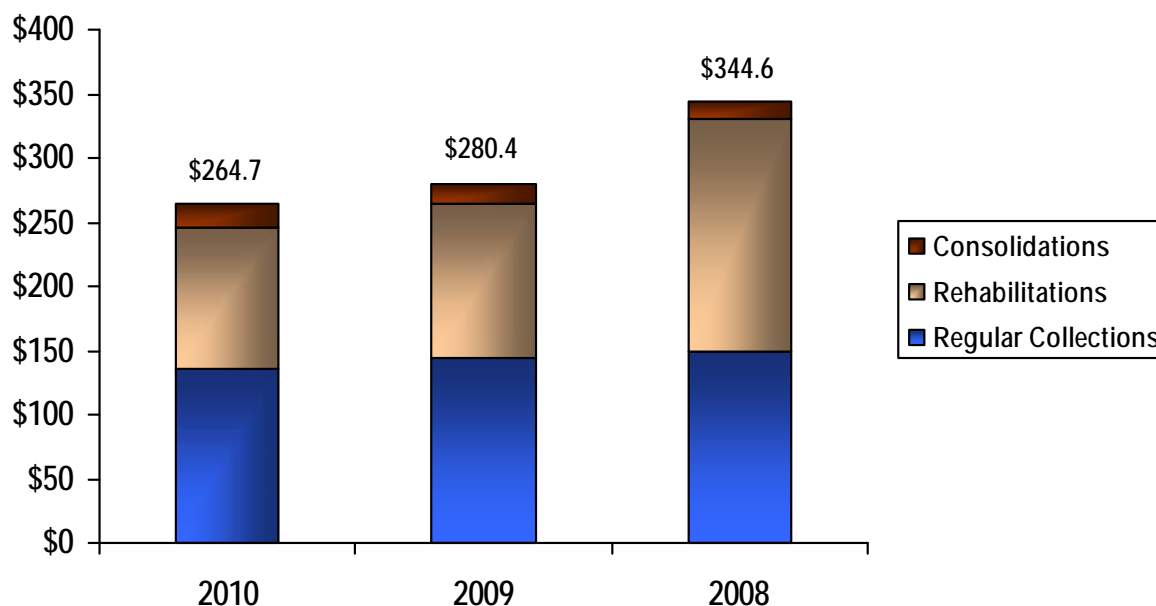
Management's Discussion and Analysis (unaudited)

March 31, 2010 and 2009

Collection Revenue

As a FFEL guarantor, HESC retains a percentage determined by ED to collect defaulted student loans. Collection revenue shown below is the gross collection receipts by HESC in the respective years. HESC's primary source of revenue continues to be collection related revenue, accounting for more than half of total HESC operating fund revenue for the past five fiscal years.

Total Default Collection Recovery Dollars Collected
\$ in millions



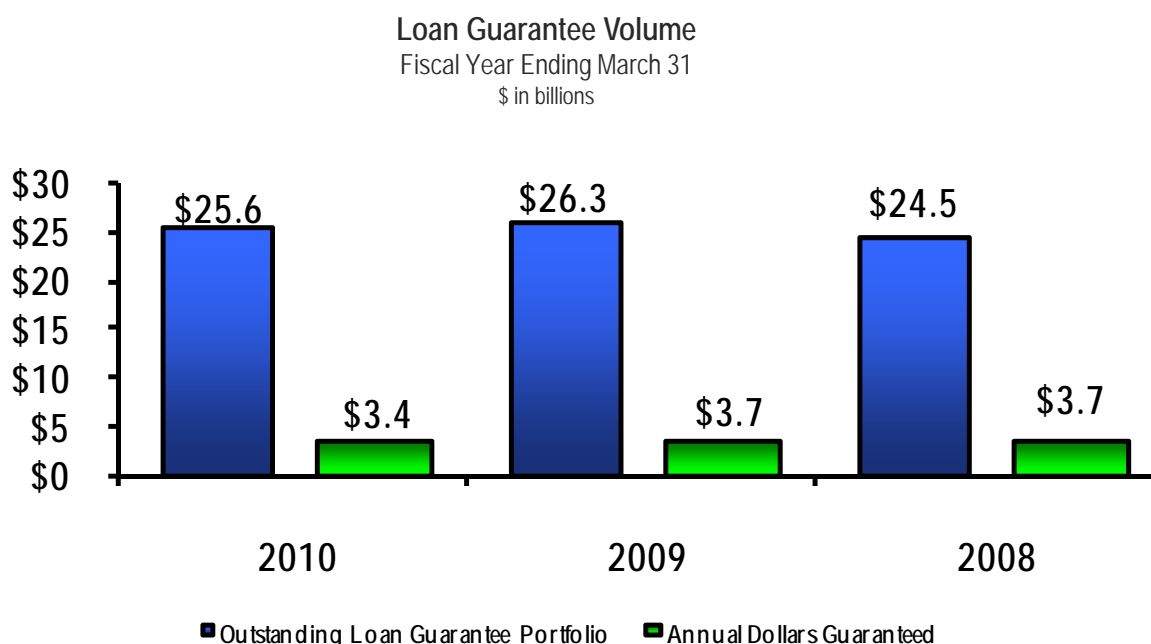
Collection Recovery Highlights for the fiscal year ending March 31,

2010	2009
<ul style="list-style-type: none"> • Collections on rehabilitated loans decreased 9% to \$109.5 million due to a discount paid to HESC's rehabilitation lender. • Total regular collections decreased 5% from \$143.3 million in 2009 to \$135.8 million in 2010, due to current economic conditions. • Federal direct default consolidation revenue increased \$3 million during the fiscal year from \$16.3 million in 2009 to \$19.3 million, as part of HESC's collection strategy. 	<ul style="list-style-type: none"> • Collections on rehabilitated loans decreased 33.5% to \$120.7 million. This decrease is a result of the loss of lenders participating in the rehabilitation program. • Total regular collections decreased 4% from \$149.3 million to \$143.3 million, due to current economic conditions. • Federal direct default consolidation revenue increased \$3.1 million from \$13.2 million to \$16.3 million, due to a change in collection strategy as a result of the loss of rehabilitating lenders.

New York State Higher Education Services Corporation
 Management's Discussion and Analysis (unaudited)
 March 31, 2010 and 2009

Operating Fund Administration Revenue on FFEL Guaranteed Loans

As a FFEL guarantor, HESC receives fee revenue for issuing new loan guarantees and for administering the outstanding guarantee loan portfolio. Administrative fee income decreased \$2.5 million and \$4.8 million respectively for the fiscal years ended March 31, 2010 and 2009.



Loan Guarantee Volume	Loan Guarantee Revenue
<ul style="list-style-type: none"> HESC guaranteed \$3.4 billion in student loans during the fiscal year ending March 31, 2010. New loan guarantees decreased \$266 million or 7.4%, and consolidation loans decreased \$21.5 million or 90.2% during fiscal year 2009-2010. New loan guarantees in 2009 were \$3.7 billion, up \$500 million from 2008. Consolidation loan guarantees declined \$500 million or 94.9% during fiscal year 2008-2009. 	<ul style="list-style-type: none"> HESC's outstanding portfolio balance decreased by \$700 million or 3% for the current fiscal year ending March 31, 2010. The AMF revenue, based on outstanding portfolio balance, decreased approximately \$.4 million. A decrease in AMF revenue of \$3.5 million was also experienced in fiscal year 2009 due to the October 1, 2007 reduction in AMF rate. New loan guarantee revenue fell \$.25 million for the fiscal year ending March 31, 2010. An increase in new loan guarantee revenue of \$1.4 million was experienced during fiscal year ending March 31, 2009.

New York State Higher Education Services Corporation
 Management's Discussion and Analysis (unaudited)
 March 31, 2010 and 2009

Total HESC Operating Fund Expenses

2010

Operating Expenses

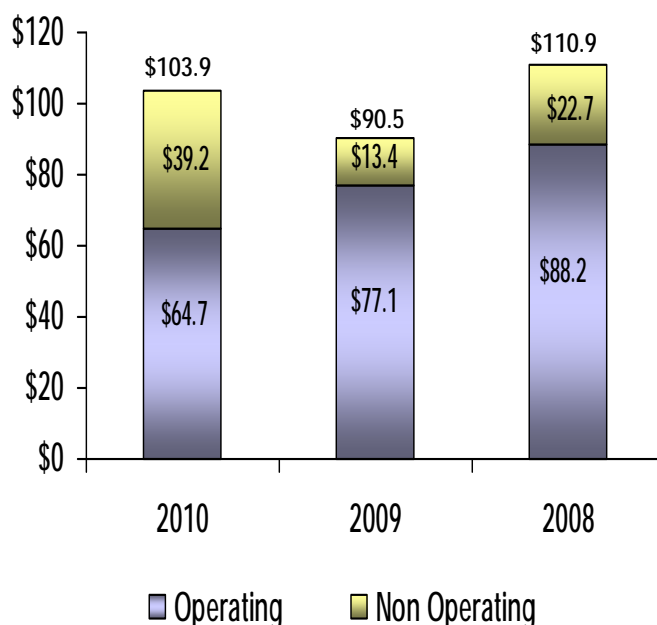
- Outsourced vendor collection fees decreased \$3 million or 20% as a result of a renegotiated rate paid to vendors on rehabilitation recoveries.
- Payments to Office for Technology decreased \$1.4 million or 36.5% due to the transfer of the printing of FFEL default bills to an external system and streamlining in house processing.
- Contract programmer expenses decreased approximately \$2 million or 48% as a result of cost cutting measures implemented by management.
- Payroll and fringe benefits decreased \$6.7 million or 15% due to a reduction in full time equivalent employees.

Non Operating Expenses

- The Operating Fund contributed \$22.2 million to subsidize the Tuition Assistance Program.
- Grant and scholarship programs expenses decreased \$.5 million.
- HESC incurred \$4.6 million in expenses as a result of the new NYHELPS program.

State Fiscal Year Ended March 31

\$ in millions



2009

Operating Expenses

- Outsourced vendor collection fees decreased \$5.6 million or 27% as a result of the loss of lenders participating in the rehabilitation program.
- Payments to Office for Technology decreased \$0.9 million or 19.5% as a result of rate and volume changes from 2008.
- Contract programmer expenses decreased \$1.4 million or 27% as a result of cost cutting measures mandated by the governor.
- Miscellaneous expense decreased due to the one time expenditure in 2007-2008 for the financial literacy planning tool.

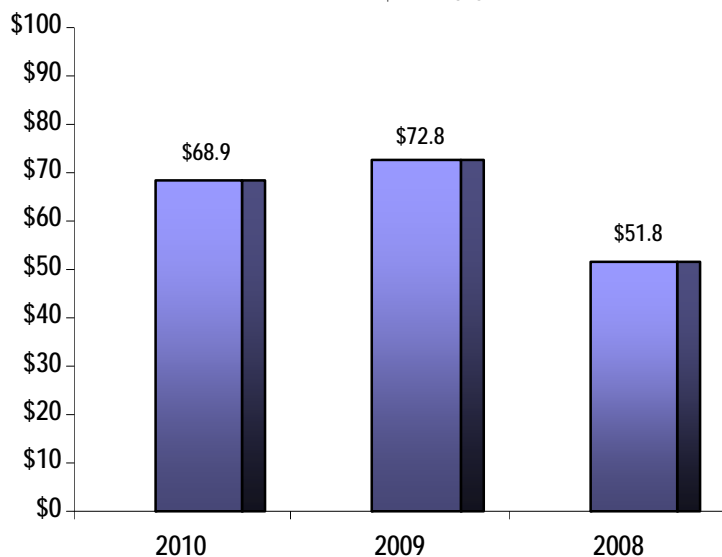
Non Operating Expenses

- The Operating Fund was not required to subsidize \$8 million to the Tuition Assistance Program.
- Grant and scholarship programs related expenses decreased \$.8 million.

New York State Higher Education Services Corporation
 Management's Discussion and Analysis (unaudited)
 March 31, 2010 and 2009

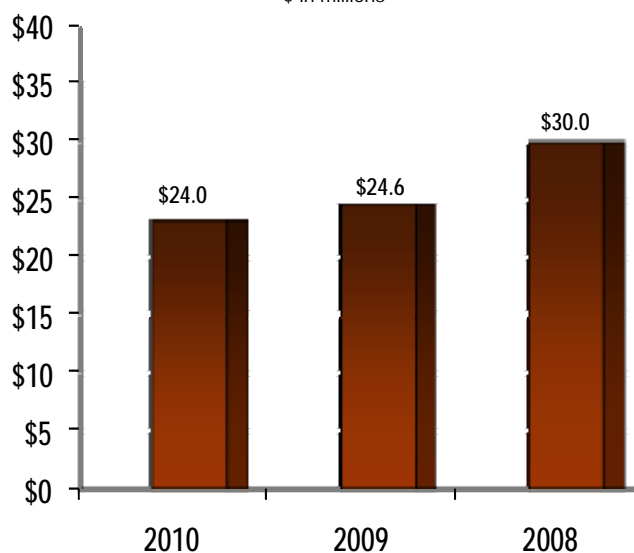
Assets & Liabilities – Operating Fund

Assets
 Fiscal Year Ending March 31
 \$ in millions



- Total operating assets are primarily current assets, consisting of cash and cash equivalents, receivables due from the U.S. Department of Education and the Federal Fund.
- Total assets decreased \$4 million or 6% primarily as a result of the decline in cash flows of \$2.9 million and a \$.9 million change in the inter-fund balance from receivable to a payable in fiscal year 2009 – 2010.
- Administrative fees receivable decreased \$0.4 million as a result of a decrease in loans guaranteed this period.

Liabilities
 Fiscal Year Ending March 31
 \$ in millions



- Accounts payable and accrued liabilities represented 70% of total liabilities for fiscal the year ending March 31, 2010 and 66% of total liabilities for the fiscal year ending March 31, 2009.
- Accounts payable and interfund payables increased \$1 million in fiscal year 2010.
- Amounts payable through the EFT system declined \$2.5 million.
- Non current liabilities increased \$1.1 million, as a result of the increase in the allowance for default aversion fee refund.

New York State Higher Education Services Corporation

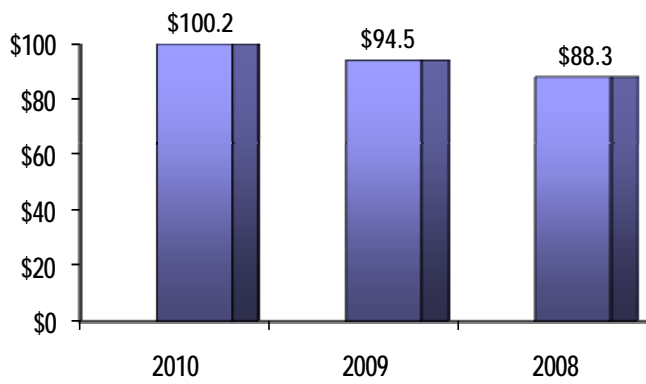
Management's Discussion and Analysis (unaudited)

March 31, 2010 and 2009

The Federal Student Loan Reserve Fund (Federal Fund)

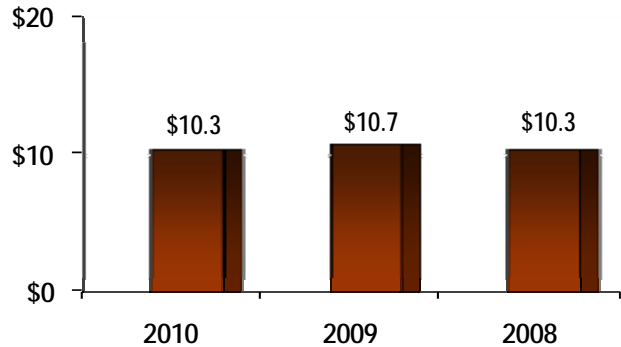
The Federal Fund assets are owned by the U.S. Department of Education (ED) and have restricted use, primarily to reimburse lender claims for defaulted student loans.

Federal Fund Assets
Fiscal Year Ending March 31
\$ in millions



- The Federal Fund's cash and cash equivalents increased \$14.3 million or 24% in fiscal year 2009-2010 as a result of cash flows of \$14.3 million.
- The reinsurance receivable decreased \$10.3 million as a result of increased rehabilitation collections due to ED at March 31, 2010.
- The interfund DAF allowance was increased \$1.1 million in fiscal year 2010 based on current refund statistics.

Federal Fund Liabilities
Fiscal Year Ending March 31
\$ in millions



- Current liabilities at March 31, 2009 included \$0.4 million in inter-fund payables to the Operating Fund which were settled during the fiscal year 2009-2010.
- Non current liabilities include \$10.3 million for non-interest bearing advances from the US Department of Education, for the purpose of helping to strengthen FFELP through the infusion of additional working capital.

New York State Higher Education Services Corporation

Management's Discussion and Analysis (unaudited)

March 31, 2010 and 2009

Significant Known Facts, Decisions, or Conditions

- As a result of the March 30, 2010 enactment of the Health Care and Education Reconciliation Act (HCERA) (HR4872), the Federal Family Education Loan Program (FFELP) was eliminated effective July 1, 2010. No new (first disbursed) Stafford, PLUS or consolidated loans may be disbursed through the FFELP after June 30, 2010. Existing FFELP loans will continue to be eligible for program benefits. Beginning July 1, 2010, all new Stafford, PLUS and consolidation loans will be made under the U.S. Department of Education's Direct Loan Program.
- HESC will remain responsible for the administration of its existing FFELP portfolio of both active and defaulted loans and in addition is actively pursuing the possibility of providing the Department of Education additional post default collection services.
- HESC has been designated by Governor Paterson as the agency to administer the New York Higher Education Loan Program (NYHELPS), in partnership with private lenders and SONYMA. NYHELPS is a private student loan program for New York State residents attending participating institutions in the State. The first NYHELPS loan was disbursed January 2010. Financial activity associated with NYHELPS is accounted for outside these GSLP financial statements.
- The Operating Fund will continue to support the operational expenses of the Grants and Scholarship program in the amount of approximately \$11.2 million for the fiscal year 2010-2011.
- HESC's fringe benefit rate for fiscal year 2010-2011 has increased to 47.2%.

Contacting Financial Management

- This financial report is designed to provide our customers, business partners and creditors with a general overview of the Guaranteed Student Loan Programs' finances. For detailed information regarding the FFEL Program, you may also review our annual report on the web at www.hesc.org.
- Questions about this report can be directed to HESC's Chief Financial Officer, Matthew Downey at (518) 474-8893 or mdowney@hesc.org.

**THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION**

Statements of Net Assets

March 31, 2010 and 2009

Assets	2010		2009	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Current assets:				
Cash and cash equivalents (note 4)	\$ 59,220,817	72,440,025	62,077,024	58,091,886
Receivables due from U.S. Department of Education:				
Administrative fees (note 5)	8,942,246	—	9,386,837	—
Reinsurance	—	20,158,096	—	30,473,096
EFT fees receivable from lenders	217,032	—	269,259	—
Interfund balances (note 7)	—	477,394	423,060	—
Due from lenders for default fee billing (note 13)	—	1,908,153	—	1,770,036
Prepaid expenses and other assets	301,216	—	564,471	—
Accrued interest	1,283	—	79	159
Total current assets	<u>68,682,594</u>	<u>94,983,668</u>	<u>72,720,730</u>	<u>90,335,177</u>
Noncurrent assets:				
Interfund Default Aversion Fee Allowance (note 5)	—	5,262,740	—	4,183,458
Capital assets, net (note 10)	203,550	—	38,559	—
Total noncurrent assets	<u>203,550</u>	<u>5,262,740</u>	<u>38,559</u>	<u>4,183,458</u>
Total assets	<u>68,886,144</u>	<u>100,246,408</u>	<u>72,759,289</u>	<u>94,518,635</u>
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued liabilities (note 16)	16,681,411	—	16,215,027	—
Interfund balances (note 7)	477,394	—	—	423,060
Amounts payable to lenders through EFT (note 4)	1,611,455	—	4,164,666	—
Total current liabilities	<u>18,770,260</u>	<u>—</u>	<u>20,379,693</u>	<u>423,060</u>
Noncurrent liabilities:				
Advance from U.S. Department of Education (note 11)	—	10,300,348	—	10,300,348
Interfund Default Aversion Fee Allowance (note 5)	5,262,740	—	4,183,458	—
Total noncurrent liabilities	<u>5,262,740</u>	<u>10,300,348</u>	<u>4,183,458</u>	<u>10,300,348</u>
Total liabilities	<u>24,033,000</u>	<u>10,300,348</u>	<u>24,563,151</u>	<u>10,723,408</u>
Net assets:				
Invested in capital assets	203,550	—	38,559	—
Restricted – property of U.S. Department of Education	—	89,946,060	—	83,795,227
Restricted – for student aid related activities	44,649,594	—	48,157,579	—
Total net assets	<u>\$ 44,853,144</u>	<u>89,946,060</u>	<u>48,196,138</u>	<u>83,795,227</u>

See accompanying notes to financial statements.

**THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION**

Statements of Revenue, Expenses, and Changes in Net Assets
Years ended March 31, 2010 and 2009

	2010		2009	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Operating revenues:				
Defaulted loan collections (note 6)	\$ 60,662,495	204,006,782	73,272,445	207,135,793
Administrative and program fee income (note 5, 13)	33,284,593	29,951,609	35,780,279	29,908,325
Reimbursement on purchases of default loans from lenders (note 12)	—	561,625,491	—	514,279,039
Other revenue	1,663,166	4,029	1,432,594	1,986
Total operating revenues	<u>95,610,254</u>	<u>795,587,911</u>	<u>110,485,318</u>	<u>751,325,143</u>
Operating expenses:				
Salaries and employee benefits	37,359,802	—	44,027,521	—
General and administrative	11,915,047	—	13,369,354	—
Collections	11,912,097	—	14,941,352	—
NYS Office for Technology equipment usage charges	2,435,732	—	3,837,644	—
D.M.I. program expenses	1,031,883	—	940,134	—
Default aversion fee subsidy	—	4,984,022	—	6,842,229
Purchases of default loans from lenders (note 12)	—	584,411,391	—	534,694,423
Defaulted loan collections paid to U.S. Department of Education	—	195,312,889	—	199,039,675
Depreciation (note 10)	42,609	—	42,670	—
Other expense	—	5,933	—	5,769
Purchases of defaulted State loans from lenders	22,086	—	383	—
Total operating expenses	<u>64,719,256</u>	<u>784,714,235</u>	<u>77,159,058</u>	<u>740,582,096</u>
Operating income (loss)	<u>30,890,998</u>	<u>10,873,676</u>	<u>33,326,260</u>	<u>10,743,047</u>
Nonoperating revenues (expenses):				
Interest income	158,125	56,850	752,434	743,364
Gear Up operational expenses	(559,533)	—	(1,066,344)	—
New York State initiatives (note 8)	(38,612,277)	—	(12,304,026)	—
Total nonoperating (expenses) revenues, net	<u>(39,013,685)</u>	<u>56,850</u>	<u>(12,617,936)</u>	<u>743,364</u>
Transfer from/(to) Federal Fund (note 9)	4,925,705	(4,925,705)	7,000,000	(7,000,000)
Transfer of Federal default fee (note 13)	(146,012)	146,012	(1,295,148)	1,295,148
(Decrease)/increase in net assets	<u>(3,342,994)</u>	<u>6,150,833</u>	<u>26,413,176</u>	<u>5,781,559</u>
Net assets, beginning	<u>48,196,138</u>	<u>83,795,227</u>	<u>21,782,962</u>	<u>78,013,668</u>
Net assets, ending	<u>\$ 44,853,144</u>	<u>89,946,060</u>	<u>48,196,138</u>	<u>83,795,227</u>

See accompanying notes to financial statements.

**THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
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Statements of Cash Flows

Years ended March 31, 2010 and 2009

	2010		2009	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Cash flows from operating activities:				
Receipts from:				
Collections	\$ 62,146,505	202,928,376	72,783,491	207,410,113
Administrative fees	34,688,282	—	35,316,963	—
Other sources	1,700,983	4,030	1,315,236	1,986
Reimbursement on purchases of default loan purchases	—	571,971,998	—	512,274,538
Federal default fee income from lenders	—	29,813,489	—	28,138,289
Payments for:				
Salaries and employee benefits	(39,785,622)	—	(44,032,363)	—
Administrative fees	—	(5,943,120)	—	(6,980,661)
Purchases of default loans from lenders	(22,086)	(584,411,391)	(383)	(534,694,423)
Collections paid to U.S. Department of Education (ED)	—	(195,344,394)	—	(199,141,175)
General, administrative and other expenses	(28,213,987)	(5,933)	(36,821,589)	(5,769)
Net cash provided by operating activities	<u>30,514,075</u>	<u>19,013,055</u>	<u>28,561,355</u>	<u>7,002,898</u>
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(38,041,528)	—	(13,655,802)	—
Interfund Transfers	(203,780)	203,780	(2,751,832)	2,751,832
Payment from ED for additional rehabilitated loans	4,925,705	(4,925,705)	7,000,000	(7,000,000)
Net cash (used in) provided by noncapital financing activities	<u>(33,319,603)</u>	<u>(4,721,925)</u>	<u>(9,407,634)</u>	<u>(4,248,168)</u>
Cash flows from capital and related financing activities:				
Purchases of capital assets	(207,600)	—	—	—
Net cash used in capital and related financing activities	<u>(207,600)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Cash flows from investing activities:				
Interest received	156,921	57,009	753,451	745,570
Net cash provided by investing activities	<u>156,921</u>	<u>57,009</u>	<u>753,451</u>	<u>745,570</u>
(Decrease) increase in cash and cash equivalents	(2,856,207)	14,348,139	19,907,172	3,500,300
Cash and cash equivalents, beginning	62,077,024	58,091,886	42,169,852	54,591,586
Cash and cash equivalents, ending	<u>\$ 59,220,817</u>	<u>72,440,025</u>	<u>62,077,024</u>	<u>58,091,886</u>

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Statements of Cash Flows

Years ended March 31, 2010 and 2009

	2010		2009	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Operating income	\$ 30,890,998	10,873,676	33,326,260	10,743,047
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	42,609	—	42,670	—
Change in assets and liabilities:				
Receivables	444,591	10,315,000	(601,748)	(3,876,036)
Other assets	315,482	(138,117)	(92,187)	—
Interfund balances	958,222	(958,222)	(378,715)	378,715
Accounts payable and accrued liabilities	(663,898)	—	(4,508,858)	—
Other liabilities	(2,553,211)	—	531,105	—
Allowance for default aversion refunds	1,079,282	(1,079,282)	242,828	(242,828)
Total adjustments	(376,923)	8,139,379	(4,764,905)	(3,740,149)
Net cash provided by operating activities	\$ 30,514,075	19,013,055	28,561,355	7,002,898

See accompanying notes to financial statements.

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(1) Organization and Operations

New York State Higher Education Services Corporation (HESC) is an agency of New York State (the State) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of the State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program.

FFELP was established by Congress and is administered by the U.S. Department of Education (ED) through HESC and other guaranty agencies. As a guaranty agency, HESC makes loans available through lending institutions to students attending colleges, universities, postsecondary educational, and vocational schools. FFELP allows HESC to guarantee repayment of principal and accrued interest to lenders for eligible student loans. HESC has the responsibility of processing loans submitted for guarantee, issuing loan guarantees, providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and performing certain collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs include the residual activity of the State guaranteed loan program in which no new loans have been guaranteed since 1984.

On March 30, 2010, the President signed into law H.R. 4872 – The Heath Care and Education Reconciliation Act of 2010, which terminates new loan originations in the FFELP on June 30, 2010. Effective July 1, 2010, all new Stafford, PLUS or consolidated loans will be made under the U.S. Department of Education Direct Loan Program. Existing FFELP loans will continue to be eligible for program benefits. The Guaranteed Student Loan Programs' Operating Fund and Federal Fund of HESC will continue to administer its existing FFELP portfolio of both active and default student loans. As a result of the new legislation, loan processing and issuance fee revenue and federal default fee revenue will be reduced and ultimately eliminated as a revenue source.

The accompanying financial statements only reflect the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC. The Federal Fund assets, and earnings on those assets, are restricted in use and are property of the U.S. Department of Education. The Operating Fund is property of HESC and its assets and earnings are restricted in use for student financial aid related activities as required by the Higher Education Amendments of 1998 (1998 Amendments).

HESC also administers the Tuition Assistance Program, State Scholarship Programs, and Robert L. Byrd Federal Scholarship Program under which students apply for payments to attend eligible educational institutions based on family income and/or academic achievement. In addition, HESC partners with colleges, universities, school districts and other educational organizations in administering the Federal GEAR UP and College Access and Challenge Grant which are designed to increase the number of low income students who are prepared to enter and succeed in postsecondary education. These programs are not included in the accompanying financial statements.

In 2009 the State legislature created the New York Higher Education Loan Program (NYHELPS), a State sponsored student loan program for New York residents attending participating institutions in the State. HESC administers the program in partnership with the State of New York Mortgage Agency (SONYMA) and participating lending institutions. HESC's ongoing responsibilities will include but not be limited to:

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monitoring the origination and servicing of loans, marketing the program to various audiences, providing financial literacy education, default aversion services and collecting on defaulted accounts. The financial activities of NYHELPS are not included in the accompanying financial statements.

(2) Significant Accounting Policies

(a) Basis of Accounting

The Guaranteed Student Loan Programs’ Operating Fund and Federal Fund follow U.S. generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). The Guaranteed Student Loan Programs’ Operating Fund and Federal Fund follow fund accounting in which resources are classified for accounting and reporting purposes into funds established according to their purpose.

The Guaranteed Student Loan Programs’ funds consist of the Federal Fund and the Operating Fund. The Federal Fund finances FFELP insurance activities, while the Operating Fund accounts for substantially all FFELP operational costs as well as financial aid awareness and related outreach activities. The two funds together constitute the Guaranteed Student Loan Programs and are accounted for as business-type activities using the flow of economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the cost is incurred regardless of the timing of the related cash flow.

In accordance with GASB Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, the Operating Fund and Federal Fund apply all applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Funds have elected not to apply accounting standards issued after November 30, 1989 by FASB and APB.

(b) Cash and Cash Equivalents

Cash and cash equivalents consisting of United States Treasury Bills and collateralized short-term repurchase agreements with original maturities of 90 days or less, are carried at cost plus accrued interest, which approximates fair value. Investment income represents interest on deposits and gains and losses.

(c) Operating Revenues and Expenses

Operating revenues and expenses result generally from activities associated with FFELP, including collection on defaulted loans, default prevention, and default loan purchase activities. All revenues and expenses not derived from the administration of FFELP are reported as nonoperating revenues and expenses.

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(d) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management estimates include useful lives in depreciating capital assets, and anticipated future default aversion fee refunds. Actual results could differ from those estimates.

(3) Guaranteed Loans Outstanding and Respective Unpaid Balances

As of March 31, 2010 and 2009, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately \$25,562,000,000 and \$26,249,000,000, respectively, made to students by participating lending institutions. Substantially all of that amount is guaranteed by the U.S. Department of Education, with an amount representing less than 1% guaranteed by the State. At March 31, 2010 and 2009, the unpaid balances were approximately \$22,930,000,000 and \$23,772,000,000, respectively.

HESC's management anticipates that a certain portion of the loans outstanding as of March 31, 2010 will go into default status, requiring the Federal Fund to purchase loans from lenders. Because the majority of these loans are federally guaranteed, the Federal Fund will be reimbursed by the U.S. Department of Education.

(4) Cash and Cash Equivalents

In accordance with HESC's investment policy, investments are made in low risk securities that are fully collateralized by the dealer. Cash equivalents are short-term investments with original maturities of three months or less when purchased are generally short-term United States Treasury Bills and collateralized repurchase agreements. Cash equivalents are recorded at cost plus accrued interest, which approximates the fair value at March 31, 2010 and 2009. Federal Fund amounts are restricted in use and are property of the U.S. Department of Education. HESC actively manages the investments of its cash balances to minimize its uninvested funds. Excess cash balances are generally invested in short-term repurchase agreements until such time that HESC anticipates the funds will be required for operational needs. Cash balances in an administrative account in the Operating Fund are invested in the New York State Comptroller's short-term investment pool. These cash balances are available to HESC upon demand.

Custodial credit risk for cash and cash equivalents is the risk that in the event of the failure of the counterparty to a transaction, HESC will not be able to recover the value of cash and cash equivalents that are in the possession of an outside party. In order to manage this risk, HESC requires collateral consisting of Federal government obligations or agency instruments guaranteed by the Federal government pursuant to its investments in repurchase agreements and delivery to its Trustee (agent) of all securities purchased and collateral for repurchase agreements, regardless of the seller institution. To manage custodial credit risk on deposits, HESC requires that its depository banks pledge collateral based on available bank balances. Additionally, HESC's investment policy limits the amount of funds which may be invested at any given dealer to \$75 million.

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Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a cash equivalent. HESC's policy for managing this risk is to hold cash equivalents to maturity, at which time the fair value of the investment is equal to its stated maturity value.

Included in Operating Fund bank balances are \$1,611,455 for 2010 and \$4,164,666 for 2009, which were deposited by lenders, to be forwarded to schools generally within one business day under an electronic funds transfer program (EFT). The offsetting liability is shown as amounts due to lenders, which are held by HESC for future disbursement.

Cash and cash equivalents at March 31 were as follows:

	<u>2010</u>	<u>2009</u>
Operating Fund:		
Repurchase agreements	\$ 30,000,000	28,617,923
Cash in State Comptroller's short-term investment pool and cash in bank	29,200,817	33,428,101
Petty cash and travel imprest accounts	20,000	31,000
Operating Fund cash and cash equivalents	<u>\$ 59,220,817</u>	<u>62,077,024</u>
Federal Fund:		
Repurchase agreements	\$ —	73,705,509
Cash-net of outstanding bank checks	72,440,025	(15,613,623)
Federal Fund cash and cash equivalents	<u>\$ 72,440,025</u>	<u>58,091,886</u>

All Federal Fund cash was held at Key Bank as of March 31, 2010 due to a lack of available collateral amongst the repurchase agreement dealers that HESC uses for investments. At the time, all balances at Key Bank were covered by the FDIC's Transaction Account Guarantee Program, which temporarily removed the insurance cap on balances. The Operating Fund daily liquid cash was also held at Key Bank at the time, however, a term repurchase agreement purchased earlier was outstanding as of March 31, 2010. As of March 31, the cost and fair value of cash equivalents are as follows:

<u>Operating Fund</u>	<u>2010</u>		<u>2009</u>	
	<u>Cost</u>	<u>Fair value</u>	<u>Cost</u>	<u>Fair value</u>
Held by HESC's agent in HESC's name	\$ 30,000,000	30,000,000	28,617,923	28,617,923

<u>Federal Fund</u>	<u>2010</u>		<u>2009</u>	
	<u>Cost</u>	<u>Fair value</u>	<u>Cost</u>	<u>Fair value</u>
Held by HESC's agent in HESC's name	\$ —	—	73,705,509	73,705,509

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(5) Operating Administrative Fees

The 1998 Amendments established three fees recorded in the Operating Fund for administering the loan program on behalf of the Federal Government based on performance as a guaranty agency.

A Default Aversion Fee is recognized for default aversion activities on delinquent loans at the time the lenders request aversion assistance between the 60th and 120th days of a borrower's delinquency. A fee of 1% of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for preclaim assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund in the event the loan is later paid as a default claim. Accordingly, an estimate of default aversion fee refunds of \$5,262,740 and \$4,183,458 at March 31, 2010 and 2009, respectively, are reported as a liability in the Operating Fund and a receivable in the Federal Fund. The net default aversion fee is transferred from the Federal Fund to the Operating Fund on a monthly basis.

A Loan Processing and Issuance Fee is paid based on the original principal amount of new loans guaranteed and disbursed during the period at a rate of 0.40%. This fee is paid to the Operating Fund on a quarterly basis by the U.S. Department of Education.

An Account Maintenance Fee is calculated on the original principal amount of loans outstanding at a rate of 0.06%. This fee is paid to the Operating Fund either directly by the U.S. Department of Education or as an authorized transfer from the Federal Fund on a quarterly basis.

For the years ended March 31, 2010 and 2009, the administrative fees receivable from U.S. Department of Education consisted of the following:

	2010	2009
Operating Fund:		
Loan processing and issuance fee receivable	\$ 5,107,270	5,409,741
Account maintenance fee receivable	3,834,976	3,977,096
	\$ 8,942,246	9,386,837

For years ended March 31, 2010 and 2009, administrative fee income is as follows:

	2010	2009
Operating Fund:		
Default aversion fee, net of estimated refunds	\$ 4,984,022	6,842,229
Loan processing and issuance fee	12,259,720	12,515,243
Account maintenance fee	16,040,851	16,422,807
	\$ 33,284,593	35,780,279

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Gross default aversion fee income for the years ended March 31, 2010 and 2009 was \$11,431,620 and \$11,952,738, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2010 and 2009, the default aversion fee allowance estimate was 45% and 35% of default aversion fee income, respectively. The estimate of the refunds for 2010 is based on the current year's refunds to revenue, which reflects actual experience. In February 2010, HESC made an additional adjustment of \$1,314,801 for refunds during 2009-10 based on actual refund activity during the year.

(6) Collections on Defaulted Loans

HESC management is required by Federal statutes to pursue collections on loans upon default claim payment. Collections on defaulted loans and related complements are recorded at the time such collections are received. All collection receipts are initially deposited in the Operating Fund and daily estimated collection transfers are made to the Federal Fund. The Operating Fund retained 16% of borrower payments, approximately 37% of rehabilitation collection payments and the Operating Fund's retention on consolidated loans is 10% of principal and interest at the time of consolidation.

(7) Interfund Balances

Interfund balances are monies due to and/or due from the Federal Fund to the Operating Fund and includes collection transfer balances, default aversion fees and federal default fees pending transfer. A daily transfer between funds is made based on an estimate of ED's equitable share of daily collections. A final settlement for the actual amount of collections due to the Federal Fund is made at month end.

In fiscal year 2010, the Operating Fund had a net interfund payable balance of \$477,394 which included a payable to the Federal Fund for underpayment of collections activity of \$1,297,065. In fiscal year 2009, the Operating Fund had a net interfund receivable balance of \$423,060 which included a payable to the Federal Fund for underpayment of collections activity of \$218,659. In both years, the appropriate interest earnings were transferred with the funds' settlement at the end of the month. In addition, there were interfund default aversion fee receivable balances in the Operating Fund of \$804,965 and \$684,781 at March 31, 2010 and 2009, respectively. The default prevention fee payable from the Operating Fund to the Federal Fund totaled \$14,706 and \$43,062 at March 31, 2010 and 2009, respectively.

(8) New York State Initiatives

The 2009-2010 New York State budget required the Operating Fund to pay the operational expenses related to the administration of the State's grant and scholarship programs, which amounted to approximately \$11.8 million and \$12.3 million in 2009-2010 and 2008-2009, respectively.

The 2009-2010 New York State budget appropriated \$22.2 million of Operating Funds to subsidize the Tuition Assistance Plan (TAP) transferred in March 2010. The New York State budget did not require an appropriation in March 2009.

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In fiscal year 2009-2010, HESC's Operating Fund incurred costs of \$4.6 million as part of New York State's new loan program, NYHELPS implementation.

The activities of these programs are excluded from the accompanying financial statements.

(9) Transfer from/(to) Federal Fund

On October 7, 2005, HESC submitted a letter for approximately \$16.9 million to the U.S. Department of Education (ED) seeking reimbursement for additional rehabilitated loan retention not previously requested, for the periods April 1996 through September 2004. The amount of reimbursement requested represents agency retention on rehabilitated loans. From April 1996 through September 2004, HESC retained only the collection costs charged borrowers on rehabilitated loans. The remaining funds, including agency retention, were transferred to ED. Subsequent to clarification by ED, HESC changed its procedures prospectively to report rehabilitated loans and calculated agency retention as instructed. On April 19, 2007, HESC received a letter from the Chief Business Operations Officer, Financial Student Aid at ED resolving the outstanding rehabilitation issue. ED authorized HESC to transfer amounts in the Federal Fund which exceed the minimum required reserve level until the full \$16.9 million is recuperated in the Operating Fund. This agreement is valid from September 30, 2007 to September 30, 2010. HESC transferred \$5 million from the Federal Fund to the Operating Fund as part of the rehabilitation recuperation in 2007-2008, and \$7 million in 2008-2009. The remaining balance of \$4.9 million was transferred October 15, 2009.

(10) Capital Assets

Capital assets are recorded at cost. Capital assets are defined as assets with initial, individual costs exceeding a capitalization threshold of \$40,000. Depreciation for Operating Fund assets is based on an estimated five year useful life, using an accelerated depreciation method. The majority of the Federal and Operating Funds' capital assets consists of computer equipment, while a small part of these assets are office equipment.

Capital asset activity in the Operating Fund for the year ended March 31, 2010 is as follows:

	<u>Balance April 1, 2009</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance March 31, 2010</u>
Office and computer equipment	\$ 1,370,630	207,600	—	1,578,230
Less accumulated depreciation	(1,332,071)	(42,609)		(1,374,680)
Net capital assets	<u>\$ 38,559</u>	<u>164,991</u>	<u>—</u>	<u>203,550</u>

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Capital asset activity in the Operating Fund for the year ended March 31, 2009 is as follows:

	Balance April 1, 2008	Additions	Disposals	Balance March 31, 2009
Office and computer equipment	\$ 1,370,630	—	—	1,370,630
Less accumulated depreciation	(1,289,401)	(42,670)	—	(1,332,071)
Net capital assets	<u>\$ 81,229</u>	<u>(42,670)</u>	<u>—</u>	<u>38,559</u>

At March 31, 2010 and 2009, the Federal Fund had capitalized equipment with a book value of \$294,255, respectively, which was fully depreciated.

(11) Federal Reserve Recall and Federal Advances

HESC has received, in prior years, noninterest-bearing advances from the U.S. Department of Education totaling \$10,300,348, for the purpose of helping to strengthen FFELP through the infusion of additional working capital. Under the terms of the agreement, HESC will be required to repay these advances at such time as the amount of federally guaranteed loans outstanding (note 3) is reduced to less than \$54,950,000. HESC has recorded these advances as noncurrent liabilities.

Long-term obligation activity for the year ended March 31, 2010, is as follows:

Federal Fund	Beginning balance	Additions	Reductions	Ending balance
Federal advances	\$ 10,300,348	—	—	10,300,348
Total Federal Fund	<u>\$ 10,300,348</u>	<u>—</u>	<u>—</u>	<u>10,300,348</u>

Long-term obligation activity for the year ended March 31, 2009, is as follows:

Federal Fund	Beginning balance	Additions	Reductions	Ending balance
Federal advances	\$ 10,300,348	—	—	10,300,348
Total Federal Fund	<u>\$ 10,300,348</u>	<u>—</u>	<u>—</u>	<u>10,300,348</u>

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(12) Purchase of Defaulted Federal Loans

Purchases of defaulted loans and amounts repurchased by lenders are recorded as Federal Fund activity. The reinsurance reimbursement results in a net reduction to the Federal Fund, due to reduced reinsurance rates of 98% and 95% as a result of various amendments to the Higher Education Act.

The College Cost Reduction and Access Act repealed the Secretary's authority to recognize qualified lenders, guaranty agencies and servicers as exceptional performers effective October 1, 2007. Prior to October 2007, the Higher Education Act allowed the Secretary to designate qualified lenders, guaranty agencies and servicers as exceptional performers in servicing FFELP loans making them eligible for 99% reimbursement on all claims submitted for insurance. As of October 1, 2007, all FFELP claims are paid at 97% of the claim value. As of March 2010, HESC was processing claims for 17 servicers.

(13) Federal Default Fee

As a result of the Deficit Reduction Act of 2005, signed into law by the President in February 2006, a 1% default fee must be deposited into the Federal Fund on all Stafford and PLUS loans guaranteed after July 1, 2006. The fees are Federal Fund revenue subject to the Federal Fund's restricted use. This fee replaces the guarantee fee (insurance premium) which was not a mandatory fee. HESC elected to pay the 1% default fee from the Operating Fund for loans guaranteed prior to May 1, 2008. HESC collects from lenders the 1% fee for loans guaranteed after May 1, 2008 and deposits the fee into the Federal Fund.

For the years ended March 31, 2010 and 2009, the Federal default fee revenue consisted of the following:

	2010	2009
Federal Fund:		
Default fee revenue from lenders	\$ 29,951,609	29,908,325
Default fee revenue transferred from HESC's Operating Fund	146,012	1,295,148
Total Federal default fee revenue	\$ 30,097,621	31,203,473

(14) Pension Benefits

Substantially all employees working for the Guaranteed Student Loan Programs are members of the New York State and Local Employees' Retirement System (System), a cost-sharing, multiple employer public employee retirement system. The State Comptroller is sole trustee and administrative head of the System. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to the New York State and Local Employees' Retirement System, 110 State Street, Albany, New York 12236.

The System provides retirement benefits as well as death and disability benefits. All benefits vest after five years of accredited service. Retirement benefits are established by the New York State Retirement and Social Security Law. Retirement benefits and contributory requirements depend upon the point in time at

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which an employee last joined the system. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan. The Operating Fund contributes the entire amount determined to be payable to the system for these employees. Personnel who joined the System after July 27, 1976 are required by law to contribute 3% of their gross salary for the first ten years of employment. The Operating Fund contributes the balance payable to the System for these employees.

The Operating Fund paid to the System \$3,292,422 for 2010, \$3,203,568 for 2009 and \$3,488,604 for 2008, to cover 100% of the required employer contributions for retirement benefits. These payments, made through application of the New York State Fringe Benefit rate calculated by the State's Division of the Budget, represent 9.08%, 8.58% and 9.61% of covered payroll for each of the years, respectively.

(15) Postretirement Benefits

As a State agency, HESC participates in the New York State Health Insurance Program (NYSHIP), which is administered by the State as an agent multiple employer defined benefit plan. Under the plan the State provides certain healthcare benefits for eligible retired employees and their dependents under a single employer noncontributory healthcare plan. The State's plan states that employees and/or their dependents become eligible for these benefits at 55 years of age when the employee has 10 years of State service. In calculating the 10 year service requirement, all of the employee's service need not be with the State, but may be a composite of State service elsewhere, with a minimum of three years with the State. Employees with no prior State service must work a minimum of 10 years before they and their dependents are eligible for the retirement medical benefits. Eligible retirees hired on or after November 1, 2001, contribute 10% of the cost of single coverage and 25% of the cost of dependent coverage for health insurance benefits. The State covers 100% of the cost of single and dependent coverage for employees hired before November 1, 2001. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

During the fiscal year ended March 31, 2010, NYSHIP provided health insurance coverage through the Empire Plan, an indemnity health insurance plan with managed care components; 12 Health Maintenance Organizations (HMOs); and through the Student Employee Health Plan (SEHP). Generally, these include hospital, medical, mental health and substance abuse benefits, and prescription drug benefits.

HESC's policy regarding retiree healthcare benefits is to pay the amounts billed through the State's fringe benefit rate on a pay-as-you-go basis. HESC has no obligation beyond the payment of the State's fringe benefit rate for retiree healthcare benefits. The State's policy is that the State is responsible for recording the annual required contribution and the actuarial accrued liability under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for HESC's retiree health care benefits in the State's governmental-wide financial statements.

As of March 31, 2010 and 2009, HESC had approximately 380 and 353 retired and/or spouses of retired employees, receiving retiree health care benefits with an annual pay-as-you-go cost of approximately \$3.2 million and \$2.9 million.

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(16) Employees' Vacation Pay Benefits

Under the terms of HESC management's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a combined maximum of 30 days. The Operating Fund recognizes employees' vacation pay benefits when earned. The liability for employees' vacation pay benefits is \$2,641,557 and \$2,760,994 as of March 31, 2010 and 2009, respectively, and is recorded in accounts payable and accrued expenses in the Operating Fund.

(17) Deferred Compensation

The State offers its employees, including HESC employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for participants and their beneficiaries.

(18) Leases

HESC leases office space and storage space under noncancelable operating leases effective through 2017 and under month-to-month agreements. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended March 31, 2010 and 2009, were \$1,688,180 and \$1,710,715, respectively.

(19) Contingencies

The Operating Fund and the Federal Fund are subject to ED oversight and audit that at times may result in program issues and potential liabilities payable to ED. The issues relate to possible violations of rules and regulations established by ED to administer the federal loan program. Management diligently attempts to interpret ED's rules and regulations, and believes that its implementation of policies and procedures properly adheres to those rules and regulations, and that any resulting liabilities would not be material.

During the normal course of business the Guaranteed Student Loan Programs are involved in various legal proceedings and investigations, pertaining to matters relating to the Programs' operations and activities. While these proceedings and investigations may lead to a possible liability, in the opinion of HESC management, after considering all relevant facts, these possible liabilities will not in the aggregate have a material adverse effect on the financial position of the Operating Fund or Federal Fund as of March 31, 2010 and 2009, respectively.

HESC is exposed to various risks of loss related to damage and destruction of assets, injuries to employees, or noncompliance with Federal requirements and other natural and other unforeseen disasters. HESC in general does not insure its buildings, contents or related risks and does not insure its assets for claims and assessments arising from bodily injury, property damages, and other perils. Unfavorable judgments, claims, or losses incurred by HESC are covered by the State on a self-insured basis. The State does have fidelity insurance on State employees.