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Report of Investigation of Improprieties in Student Loan Collection Activities at the New York State Higher Education Services Corporation

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I. EXECUTIVE SUMMARY

The Inspector General determined that at the instigation of Joseph Catalano, Assistant Vice President of Collection and Default Management of the New York State Higher Education Services Corporation (HESC), HESC employees Dantaida de Guzman and Mattie Douglas took unlawful actions to provide preferential treatment to Michael P. McDermott, a former Albany County Assistant District Attorney, to reduce the payments McDermott owed on his defaulted student loans.

The Inspector General also determined that de Guzman, with Catalano's approval, unlawfully waived legally required collection fees on the defaulted student loan of HESC employee Brian Cox.

The Inspector General further determined that HESC employee Donald Traver made false entries in HESC's computer system to thwart the transfer of defaulted student loans to outside collection vendors.

HESC and the Federal Family Education Loan Program

HESC serves as the guarantee agency in New York State for the Federal Family Education Loan Program (FFELP). Under FFELP, loans were made by private banks and other lenders and guaranteed by federal funds. Among its responsibilities under FFELP, HESC engages in various collection activities on defaulted student loans. In accordance with federal law and regulations, HESC assesses a collection cost on all payments made by defaulted borrowers, most recently amounting to 15.65 percent of each payment.

To assist borrowers in financial distress, HESC is permitted under federal law to reduce the defaulted borrower's required payment in certain circumstances under the "reasonable and affordable" program, if the borrower qualifies. Under the "reasonable and affordable" program, HESC could allow a reduced payment plan for a maximum of one year, subject to renewal, if the borrower proves his or her inability to make payments as due and provides documentation supporting their qualification.

Michael P. McDermott

Michael P. McDermott served as lead prosecutor for the Albany County District Attorney's Office in the 2006 trial of Christopher Porco, who was convicted of murdering his father, Peter Porco, and attempting to murder his mother in November 2004 in their home in an Albany suburb. Catalano, a family friend of the Porcos, testified as a witness for prosecution, and McDermott and Catalano became friends during the trial. In November 2006, McDermott left the District Attorney's Office for private practice with an Albany law firm.

McDermott has had defaulted student loans with HESC since 1991. Between 1994 and 2007, HESC took various appropriate collection actions in regard to McDermott's failure or inability to make loan payments. However, commencing in May 2007, after the Porco trial and Catalano's intervention, McDermott started receiving benefits to which he was not entitled.

In May 2007, McDermott contacted Catalano, who in his HESC position has authority to waive fees on defaulted student loans under appropriate circumstances. McDermott told Catalano that he was having difficulty repaying his loans and asked if Catalano could provide him with the name of a HESC employee to whom he could speak and whether Catalano could "help him out." Catalano put McDermott in contact with his subordinate de Guzman. Catalano directed de Guzman to "do what you can for him," which de Guzman understood to mean, "basically make Mr. McDermott's life easy. . . . "

After receiving this direction from Catalano, de Guzman implemented a reduced payment plan for McDermott, even though McDermott failed to provide required evidence that he was entitled to this benefit due to financial difficulty. In fact, McDermott was in private law practice earning substantially more than he had in government service. By 2009, McDermott was making over $78,000 more than he had in 2006. Under the improperly granted reduced payment plan in effect from 2007 to the present, McDermott was billed $400 per month rather than $1,030.

In 2007, de Guzman also unlawfully removed collection costs from McDermott's loan account. As a result, between November 2007 and August 2010, McDermott was improperly exempted from paying $2,111.35 in collection costs on his defaulted loans. This number, however, is misleading and in reality would be much greater. Collection costs are only assessed if a payment is made, so this number is artificially deflated because McDermott failed to make payments on some occasions and was granted a reduced payment plan as noted above. Between November 7, 2007, and August 6, 2010, McDermott should have made at least $26,430 in payments on his student loan but, because of the special privileges afforded him by de Guzman at Catalano's instigation, McDermott only paid $13,030, over $13,000 less than appropriately due.

Further, de Guzman and Mattie Douglas, another subordinate of Catalano, improperly prevented McDermott from having his wages garnished. McDermott's account was removed from wage garnishment at least six times from May 2007 to October 2008, and delinquency or past due amounts were waived. McDermott should have been required to make up these payments, but he was not.

In October 2008, and again in January 2010, after de Guzman had been assigned to other duties, Catalano referred McDermott's account to Douglas. After speaking with McDermott in October 2008, Douglas also unlawfully removed McDermott from wage garnishment and further extended his unwarranted reduced payment plan.

De Guzman testified and Catalano concurred that she informed him of the steps she was taking on McDermott's behalf. Catalano claimed that he was ignorant of the relevant laws and guidelines and did not understand everything that de Guzman was informing him that she intended to do on McDermott's behalf. That claim is belied, however, by Catalano's acknowledged expertise and 30 years experience in student loan collections and the fact that the two subordinates to whom he directly referred the matter took similar improper actions.

Brian Cox

Brian Cox is employed by HESC as a Student Loan Control Representative 1. Cox also had a defaulted student loan in HESC's portfolio.

The FFELP loan rehabilitation process provides a borrower with an opportunity to repair his or her credit rating. If accepted into the rehabilitation program, the loan is purchased from HESC by a private lender which pays HESC for the principal, current interest and 18.5 percent rehabilitation collection costs. These amounts are capitalized into a new loan for the borrower and the default is removed from the borrower's credit report.

Although Cox legitimately qualified for the rehabilitation program, HESC officials took improper and remarkable action to remove the rehabilitation collection costs which Cox was lawfully required to pay. Specifically, de Guzman, after obtaining Catalano's approval, unlawfully waived the rehabilitation collection costs on Cox's loan. This removal of rehabilitation collection costs was so unprecedented that HESC's computer system could not process the attempt to remove them. Donald Dugan, HESC's Director of Collections Support and Federal Reporting, devised a manner to circumvent the system's inability to process the novel waiver afforded Cox – HESC was to issue a check to the private lender to cover Cox's rehabilitation collection costs. On January 23, 2008, HESC sent a check to the lender for $7,150.80 to cover Cox's collection costs. Under federal law, HESC did not have the discretion to waive rehabilitation collection costs.

Donald Traver

Commencing in late 2008, HESC began a reorganization and computer upgrade resulting in changes to many HESC job assignments, which certain employees saw as a threat to their employment. The employees were concerned that Catalano was giving their work away to outside collection vendors.

Donald Traver is a HESC Student Loan Control Representative 2. On April 2 and 3, 2009, Traver made false entries in HESC's computer system concerning 31 defaulted student loan accounts. Namely, targeting the largest accounts at HESC scheduled to be sent to outside collection vendors, Traver falsely entered in HESC's computer system that all of these borrowers had been contacted and had promised to make payments, thus removing their accounts from being transmitted to the outside collection agencies. In reality, Traver never contacted any of these borrowers. When confronted by another HESC employee about his actions, Traver declared, "Joe Catalano is trying to take our jobs and refer them to the vendors…" and that he took his improper actions to save jobs at HESC.

After the confrontation, Traver attempted to conceal his misconduct by causing further false entries to be made in the system pretending that the prior entries were made as part of a "pilot program" and the resultant letters sent to borrowers in error.

At the time of Traver's fraud, the 31 accounts were worth over $1.25 million. His actions delayed, and in most cases obstructed, HESC's collection activities.

Inspector General's Recommendations

The Inspector General recommended that HESC take appropriate disciplinary action against Catalano, de Guzman, Douglas, Dugan, Cox, and Traver. The Inspector General also recommended that HESC take action to recover improperly waived or reduced payments from McDermott and Cox.

The Inspector General is forwarding these findings to the New York State Attorney General's Office and the New York State Commission on Public Integrity for review.

II. INTRODUCTION

Allegations

Beginning in April 2009, the Inspector General received multiple anonymous complaints that the Collections Unit at the New York State Higher Education Services Corporation, under the supervision of Joseph Catalano, Assistant Vice President of Collection and Default Management, afforded selected borrowers who had defaulted on their student loans preferential treatment based upon their acquaintance with either Catalano or his subordinate, Dantaida de Guzman. The first anonymous complaint was referred to the Inspector General by HESC Acting President Elsa Magee and Chief Financial Officer Matthew Downey. Specifically, the complaint alleged that HESC employee Brian Cox was not required to pay collection costs on his student loan while all other borrowers were assessed the fees. During the course of the investigation, the Inspector General discovered through another anonymous source that Michael P. McDermott might have already received preferential treatment, similar to Cox, at the behest of Catalano. The Inspector General received a subsequent anonymous complaint, forwarded by Downey, that HESC Collections employee Donald Traver made false entries into the HESC's computer system to thwart the transfer of defaulted student loan accounts to outside collection vendors.

Background

HESC and the Federal Family Education Loan Program

In order to understand the undue benefits conferred upon McDermott and Cox, a general understanding of the guaranteed student loan program as administered by HESC is necessary. Specifically, a discussion of the various programs which defaulted borrowers may attempt to avail themselves of, the strict prerequisites for qualification for these programs, and the costs associated with these options is required.

The Higher Education Services Corporation was established by the Legislature of the State of New York in 1974 to, among other things, guarantee federal student loans under the Federal Family Education Loan Program, 34 U.S.C. §1071 et seq. The FFELP program was established in 1965 as the single largest source of funds for education. Under FFELP, loans are made by private banks and guaranteed by federal funds. The process is administered at the state and local levels by guaranty agencies; in New York HESC serves as such a guarantee agency.[1]

As a guarantee agency under the FFELP program, HESC does not loan money to any individual borrower.[2] Rather, individual banks make loans to student borrowers and HESC guarantees the loan at the time it is obtained by the borrower. Because of this guarantee, credit review is not required for most FFELP loans, which enables students who otherwise might not be able to do so to obtain monies to fund their education. After guaranteeing the loan, HESC only becomes involved directly with the borrower after notification from the lender that the borrower is 60 to 120 days delinquent on repayment of the loan.

Once HESC is notified by the lending institution that a borrower is 60 to 120 days delinquent, HESC commences the "aversion" or "default avoidance" process. In aversions, HESC works with the individual bank and attempts to steer the borrower back into repayment. If the aversion process is successful, HESC will close its file and take no further action. If HESC and the originating bank are unable to get the borrower back into repayment within 270 days, the loan is considered in default and HESC will purchase the loan from the lending institution. Under the FFELP program, the federal government reimburses HESC for defaulted loans it purchases.

[1] Effective June 30, 2010, no new loans could be issued under the FFELP program pursuant to the terms of the federal Health Care and Education Reconciliation Act of 2010. As of July 1, 2010, all guaranteed student loans are made directly from the federal government using taxpayer funds.
[2] HESC administers programs other than FFELP, including NYHELPS and TAP which may offer loans, grants or scholarships directly to students.

Once HESC purchases a loan because the borrower has defaulted, the loan enters HESC's "collections" process. In accordance with federal law and regulations, HESC assesses a collection cost on all payments made by borrowers, which costs currently amount to 15.65 percent of each payment.[3] The purpose of collection costs is to cover the expense of HESC's collection efforts resulting from the borrower's default. Although collection costs, interest and principal collected by HESC are paid to the federal government (which already reimbursed HESC for the purchase of the loan), HESC retains a portion of every dollar generated from its collection efforts. Collections fees represent the largest source of revenue for HESC.[4] For the year ending March 31, 2009, HESC's total gross default collection revenue was $280.4 million. A total of $344.6 million was collected the previous year.

Under federal regulations as interpreted in various advisory opinions, HESC has the discretion to waive "in-house" collection costs for borrowers in default under two scenarios:[5] 1) if the borrower commences payment within the first 60 days after the loan is purchased by HESC and makes timely payments thereafter, or 2) when the account is paid in full through compromise and settlement. A settlement results in an account being deemed to be paid in full. Sometimes as part of a settlement, a portion of the collection costs, or possibly even the interest or principal, are "compromised" or 'written off.' Compromise may only occur under specific circumstances not relevant to this report other than to note that compromise and settlement always lead to the cessation of all collection activity. HESC has historically applied collection costs to payments received under a payment plan regardless of when that plan was initiated, but periodically has waived collection costs when an account is being closed through compromise or settlement.

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[3] The collection cost percentage is recalculated on a yearly basis dependent on the cost of loan collection experienced in the prior year. Collection costs may not be assessed on payments where a court order specifically prohibits collection costs or when HESC obtains a federal tax offset. In order to obtain a federal tax offset, HESC refers the names of borrowers in default to federal taxing authorities who will attach federal tax refunds and other federal payments. HESC also refers borrowers' names to New York State taxing authorities. State tax offsets, however, are subject to collection costs.

[4] HESC also receives fees from the federal government for its guarantee and aversion activity. HESC administers state funds for New York State specific grant, loan and scholarship programs.

[5] "In-house" collection costs, as opposed to "rehabilitation collection costs" (discussed below), refer to the aforementioned collection costs assessed by HESC when collecting from a borrower on a defaulted loan.

Borrowers default on their student loans for a variety of reasons. Most often, the reason provided for the default is financial hardship. Some loans qualify for forbearance or deferment. In sum, forbearance is a situation where a lender, at its discretion, may allow the borrower to delay all or part of the borrower's loan payment; deferment is a government program which requires the lender to permit the borrower to delay repayment under limited circumstances, including military service. [6] These programs rarely apply to loans once they are in HESC's portfolio as HESC only obtains loans after default and these options are usually exercised well before that time.

To assist borrowers in financial distress, HESC may also reduce the defaulted borrower's required payment under the "reasonable and affordable" program, also known as "income contingent" and "token arrangement", if the borrower qualifies.[7] In brief, under the "reasonable and affordable" program, HESC in certain specific circumstances may allow a reduced payment plan for a maximum of one year, subject to renewal upon proper presentation of then-current financial data. In order to determine whether the borrower qualifies for a reduced payment plan, HESC is required to obtain proof of financial difficulty, usually supplied by the borrower. It is the borrower's burden to prove his or her inability to make required payments to qualify for a reduced payment plan. A borrower qualifies for a reduced payment plan only if his or her expenses exceed 75 percent of income. While, with some exceptions, only necessities qualify as expenses for this calculation, HESC does not determine if the amount of the expense is reasonable. For example, HESC does not examine the size of a house to consider a mortgage payment a necessity and considers any size or amount of mortgage on a residence as an expense; therefore, payments made on a million-dollar mortgage are treated the same as payments made on a $100,000 mortgage.

[6] For further information about forbearance *see* http://www.hesc.com/content.nsf/SFC/3/Forbearance and 34 CFR §682.210; and deferment *see* http://www.hesc.com/content.nsf/SFC/3/Deferment and 34 CFR § 682.211. *See also*, http://www.studentloanborrowerassistance.org/default-and-delinquency/compromise-settlement/.

[7] For further information on the reasonable and affordable payment program, *see* http://www.hesc.com/content.nsf/SFC/3/Reasonable_and_Affordable_Repayment and 34 CFR § 682.405(b)(1)(iii).

Having one's loan placed in default has substantial financial implications for the borrower. HESC notifies credit agencies of student loans that are in default causing an adverse impact on the borrower's credit rating which affects the ability of a borrower to obtain future credit. As an option to ameliorate the effects of a default, pursuant to federal law as administered by HESC, a borrower may have the default expunged from his or her account (have the loan wiped clean) if the borrower "rehabilitates" the loan. The rehabilitation process, once completed, places the borrower in the same financial position, with the same credit rating, enjoyed prior to defaulting on the student loan.

Under federal law, specific enumerated steps must be taken to rehabilitate a loan.[8] First, the borrower must agree to a payment plan. The payment plan may be for either the full monthly amount due or a reduced amount if the borrower qualifies. The borrower must make nine out of 10 consecutive payments to qualify for a rehabilitation loan. After the borrower makes the required payments, the borrower will be mailed a rehabilitation application. If the application is submitted and accepted, the borrower must file an "Acknowledgement of Debt" whereby he or she admits the debt and agrees to pay 18.5 percent collection costs upon the rehabilitation of the loan.[9] If the borrower is qualified and accepted for rehabilitation, a lending institution will repurchase the loan if practicable. When the rehabilitation lender purchases the account from HESC, the lender pays HESC the agreed upon balance of the loan, any interest outstanding, plus a lump sum payment of 18.5 percent which constitutes rehabilitation collection costs, a sum paid to HESC to compensate the agency for the effort of rehabilitating the loan. HESC remits the principal and interest received from the new lender to the federal government minus its normal collection fee, but retains the entire 18.5 percent rehabilitation collection costs paid to it by the new lender. During the repayment of the rehabilitated loan, the borrower pays the new lender the principal, accrued interest, plus the amount assessed as rehabilitation collection costs which the new lender previously paid to HESC upon purchase of the loan. In a successful rehabilitation, HESC is repaid for the loan in its

[8] *See*, 34 CFR § 682.405.

[9] Rehabilitation collection costs serve the same general purpose as regular collection costs: to mitigate the costs to the taxpayers of collecting on student loans. Rehabilitation collection costs are paid up front when the loan is purchased by the new lender rather than when the borrower makes each payment.

portfolio plus the added rehabilitation collections costs while the borrower has the default immediately removed from his or her credit report.[10] This "win-win" situation is the single most lucrative debt recovery tool for HESC.

As a general rule, HESC attempts to collect on a defaulted loan for approximately 90 days.[11] If HESC is successful in its in-house collection attempts through contact with the borrower, promises to pay, payment plans, garnishment or similar activities, it will retain and work the account. Payment plans are established for a maximum of 10 years with HESC, or the borrower may consolidate[12] or rehabilitate the loan with HESC's assistance to obtain a longer payment term. If HESC is unsuccessful in its collection efforts, it may refer the account to one of eight private collection vendors currently under contract with HESC. HESC has employed various collection agencies over the years which are only paid if they collect on an account. Vendors are paid a percentage of the amount they collect. The vendor's fee is less than the amount paid to HESC by the federal government.

Joseph Catalano, Dantaida de Guzman, and Mattie Douglas

HESC is overseen by a Board of Trustees which meets semi-annually. Its day-to-day operations are run by a President, an Executive Vice President, and various other staff. In 2009, HESC employed a total of approximately 600 staff.

Joseph Catalano is currently the Assistant Vice President of Collection and Default Management at HESC. Catalano commenced employment with HESC in 1980 as part of its Accounting Unit. He rose through the ranks at HESC where his duties included, among other things, training staff in compliance with state and federal

[10] For more information on the rehabilitation process for student loans, see http://ed.gov/offices/OSFAP/DCS/rehabilitation.html.
[11] The minimum time period which HESC devotes to collection of defaulted accounts has varied over the last decade. The general process, however, has not changed.
[12] Loan consolidation allows borrowers to combine multiple loans of differing types and repayment schedules into a single loan. Consolidation can be done at any time, including after default. For more information on consolidation, see http://www.hesc.com/content.nsf/SFC/2/Loan_Consolidation_Center.

regulations regarding student loans, drafting HESC policies regarding collections, and managing in-house and outside collection activities. In 1994, Catalano accepted employment with the State University of New York in Albany where he was the Director of the Student Loan Service Center, which duties included loan collections. He then spent five years as the Director of Collections at Solomon & Solomon, P.C., a major private collection vendor in New York, where he continued to work on student loan collection. In 2000, Catalano briefly left the collections field before returning to employment with HESC in 2004. Since 2004, Catalano has been in charge of student loan collection at HESC. Based upon his decades of experience in the field, Catalano's knowledge of the student loan process and HESC's policies and practices is vast. Robert Butler, HESC's former Chief of Operations and the staff member who recommended Catalano for his current position, informed the Inspector General that, "[Catalano] knew his business, he was perhaps one of the best people" in the field of loan collections.

By virtue of his official position at HESC, Catalano has considerable authority in the utilization of collection tools to obtain payment on student loan accounts and possesses the ability to settle student loans and to waive fees, interest and principal when the loans are paid off. Although his official status affords him wide latitude, Catalano's authority is constrained by federal law and regulations and HESC policy. Depending on the nature of the contemplated settlement, Catalano may be required to seek approval from his superiors, including the President of HESC, in order to take action to mitigate or settle a loan. When interviewed during this investigation, Catalano claimed that he is not conversant in how to use the various HESC computer systems and admitted to the Inspector General that he directs subordinate staff to make entries in the computer system to carry out his directives.

Dantaida de Guzman was the Director of Collections at HESC reporting directly to Catalano until late 2009. She is currently in charge of HESC's Aversions Unit. In 2007, Mattie Douglas became Catalano's assistant. She has since been promoted, but continues to work for Catalano in collections. For all events relevant to this report, both de Guzman and Douglas took direction from Catalano and often worked specific accounts at his behest.

Scope and Methodology of the Inspector General's Investigation

In order to investigate these multiple complaints, the Inspector General took voluntary, sworn testimony from 37 witnesses, including HESC's current and former management staff and other key individuals. In addition, the Inspector General consulted the U.S. Department of Education for this report. Several individuals were interviewed multiple times, as they possessed information relevant to more than one subject under investigation.

In conjunction with testimony from witnesses, the Inspector General examined approximately 5,000 documents obtained from HESC including policies, memoranda, internal and external correspondence, telephone records, personnel and disciplinary files, financial documents, training material, and staff e-mails, as specific communications were an integral part of the allegations. The Inspector General also reviewed thousands of pages of student loan financial records from more than 40 borrowers generated from HESC's computer systems and microfilm records.

HESC Chief Financial Officer Matthew Downey, Counsel Thomas Brennan and current Director of Collections Frank Brockley cooperated fully in this investigation and assisted the Inspector General with the interpretation of HESC records and financial data used in this report. Acting President Elsa Magee, Downey, Brennan and Brockley are also responsible for ongoing reforms at the agency.

HESC maintains two computer software systems which are relevant to this investigation. The new system, the DRS system, is a collections tool and has been in use at HESC since late 2008 and, as of late 2009, all collection activity has been migrated to the DRS system. The former collection system, the DMCS system, is still in use as the accounting system and official record of HESC activity. There is no separate paper record of HESC activities pertaining to borrowers' accounts other than retention of incoming mail. The DMCS system has multiple internal reports. The Inspector General utilized three main report screens in its investigation: the case comments screen, the critical change screen, and the transaction history file. HESC employees are required to record all contacts with borrowers, by letter, phone, or email on the case comments screen. To the extent that any change is made to an account beyond a mere comment, the critical change screen automatically captures the change and logs the computer identification code of the person who made the change. The transaction history file shows billing amounts and payments received and credited to the account.

III. FINDINGS OF THE INSPECTOR GENERAL

Abuse of Authority by Catalano and de Guzman Regarding Michael P. McDermott

On November 15, 2004, Peter Porco was murdered and his wife brutally assaulted in their home in an Albany suburb. Porco's son, Christopher, was tried during the summer of 2006 and convicted of the crimes of Murder in the Second Degree and Attempted Murder in the Second Degree on August 10, 2006. One of the witnesses for the prosecution was Catalano, a family friend of the Porcos who testified about his conversations with Christopher Porco around the time of his murder of his father.[13] The lead prosecutor in the case for the Albany County District Attorney's Office was Chief Assistant District Attorney Michael P. McDermott. In November 2006, McDermott left the District Attorney's Office for private practice with an Albany law firm.

McDermott and Catalano live in the same Albany suburb where the murder took place. Both men testified that they did not meet until the investigation of the Porco murder. McDermott interviewed Catalano at least three times during the investigation: as part of the original criminal investigation, as part of witness preparation, and on the stand during the trial. At some point, McDermott became aware that Catalano worked for HESC, and he retained Catalano's direct telephone number at work.

McDermott has student loans in default within HESC's portfolio. McDermott's loan balance as of August 2010 is $59,192 including $8,195.76 of accrued interest. McDermott's loans originally defaulted in 1991. McDermott failed to make payment on his loan and HESC took a judgment against him in 1994. HESC received payments through the Albany County Sheriff's Department collection processes at such times when McDermott was employed and the Sheriff's Department was able to locate him. In 2002, at McDermott's request and with his assurance that he was going to consolidate or rehabilitate his loan, HESC voluntarily agreed to vacate the judgment. Once the

[13] *Porco Family Friend Testifies*, Albany Times Union, July 17, 2006.

judgment was vacated, McDermott again failed to pay the loan and refused to enter into a consolidation or rehabilitation. In April 2003, in an effort to avoid garnishment of his wages, McDermott entered into a reduced payment plan with HESC and made some payments. At the time of the Porco trial in 2006, McDermott was making payments under a properly approved reduced payment plan.

After the trial, most likely in May 2007, [14] McDermott contacted Catalano. McDermott told the Inspector General that, "[My] student loans have been an issue since after I graduated from law school." Through the years, McDermott spoke to several different HESC employees regarding his loan, including de Guzman, Deane Fish, and Robert Bates. By mid-2007, Fish had left HESC and Bates was deceased. McDermott expressed frustration with using the 1-800 number automated system at HESC, testifying, "It's a nightmare. So I was always looking for somebody who's like a live body that I could deal with." Interestingly, McDermott did not explain why in 2007 he did not directly contact de Guzman, who had previously assisted him for years with his loans. Rather, McDermott contacted Catalano. McDermott told the Inspector General that, "I don't even remember having anything but a very general conversation with Mr. Catalano saying, 'Listen, I've got these student loans — trying to deal with Higher Education is a nightmare, is there somebody that I – a real person I can speak to?' – and then having him put me in touch with Ms. de Guzman." When asked why he contacted Catalano, McDermott stated, "Simply because I found out he worked at Higher Education and he was like a person I knew I could call and say, 'Have you got a name with a phone number besides an 800 number?'"

[14] McDermott and Catalano both testified to the Inspector General that the contact was made after the trial concluded, but neither was able to pinpoint the date. Their testimony that the conversation occurred after the conclusion of the trial is confirmed by the evidence. In addition to de Guzman's testimony that Catalano referred to McDermott as a person who had been previously employed by the District Attorney's Office, HESC records assist in narrowing the possible dates when this discussion occurred. Upon review of the file, the Inspector General determined that the most likely time for the contact is between May 1, 2007, when de Guzman noted in McDermott's account that she was awaiting financial documentation in support of an application for a reduced payment plan, and May 7, 2007, when she made a contradictory entry in McDermott's account alleging that there were new rules and no documentation was necessary. She further granted McDermott a reduced payment amount of $400 for two years, a period inconsistent with both federal regulations and HESC policy.

Catalano provided a similar account of his conversation with McDermott. Catalano testified that he and McDermott had become "friends" during the Porco trial and McDermott called and informed him that he was having "financial troubles" and asked if "there are any opportunities" and "is there anything that can be done to help out in this case." Catalano averred that he informed McDermott that he did not "want to get involved" due to their friendship and that he would "hand it over to another director" and "I'm sure that . . . she will do everything in her power to take care of this in a way that's . . . appropriate, you know, to help you in any way, just to make sure he's been offered all the opportunities."

Catalano Directs de Guzman to Assist McDermott

After Catalano and McDermott spoke, Catalano contacted his subordinate de Guzman. De Guzman recalled initially receiving the account from Catalano, describing their conversation as follows: "'Taida, can you call this guy Michael McDermott?' I guess, um, ya know, he goes 'I don't know what's going on with this account . . . Take a look at it." I go 'Anybody special?' Something that we kinda say. He said, 'Well he's that guy, he worked for the ADA.'"[15] Catalano admitted giving the assignment to de Guzman, testifying, "I told Taida to take care of it and I wanted to just — myself from it 'cause I knew Mike personally, I didn't think it would be appropriate for me to get into any negotiations with him." De Guzman stated that Catalano told her to "do what you can for him," which she testified she understood to mean, "basically make Mr. McDermott's life easy."

Both de Guzman and Catalano admitted that de Guzman looked at McDermott's account and advised Catalano in several conversations of steps she wanted to take on McDermott's behalf. These steps included providing McDermott with a reduced payment plan (to which he was not entitled and not available to other borrowers), removing collection costs from the account (without any legal basis), and keeping

[15] De Guzman advised the Inspector General that she attended the Porco trial on the day Catalano testified.

McDermott out of wage garnishment (despite the fact that any other borrower under similar circumstances would have been referred for garnishment).

The Reduced Payment Plan

After the conversation between McDermott and Catalano, McDermott spoke to de Guzman on numerous occasions to obtain assistance with his account. McDermott stated that he repeatedly requested reduced payment plans from de Guzman but admitted that he did not provide any documentation in support of his applications.

Prior to Catalano's intervention in 2007, any reasonable and affordable payment plans provided to McDermott were granted in accordance with federal law. Starting in May 2007, however, after McDermott contacted Catalano, McDermott received preferential treatment inconsistent with federal law. As discussed above, in order to qualify for a reduced payment plan, a borrower must prove that reduced payments are warranted due to financial necessity. HESC has no record of the receipt of financial documentation in support of McDermott's request for a reduced payment plan after 2006. Indeed, according to entries in the computer system and copies of financial data retained on microfilm, former HESC supervisor Robert Bates was the last person to require McDermott to provide financial documentation in support of his claim of financial difficulties. If McDermott had not been granted the reduced payment plan after his conversation with Catalano, he would have been billed $1,030 per month from May 2007 onward instead of the $400 he was actually billed.

De Guzman admitted that after her direction from Catalano in 2007, she never asked McDermott to provide required documentation regarding his financial status to support a reduced payment plan. In fact, although de Guzman noted in the account that McDermott repeatedly told her that his finances had not changed, McDermott, during his interview, emphatically denied ever making that statement to de Guzman. De Guzman, equally emphatic, stated that he made the representation to her and that she relied upon

McDermott's claims of financial hardship to approve his reduced payment plan. As de Guzman stated, "He's a district attorney, I think I'd be able to trust him."

The granting of a reduced payment plan to McDermott at that time is particularly troubling in that his finances had in fact appreciably changed for the better: He had left government service for a more lucrative position at a private law firm. Indeed, not only was McDermott granted four years of reduced payments without any proof of financial distress, but he failed to notify HESC of a change in employment as required by his promissory note. About November 2006, McDermott left the employ of the Albany County District Attorney's Office, where he was earning approximately $110,224 per year. Given his prominence as the lead prosecutor in the Porco case, his new employment was the subject of an article in the Albany *Times Union*.[16] HESC did not officially become aware of McDermott's new job until October 2007, almost a year after he ceased employment with the District Attorney's Office. HESC only formally learned of McDermott's change in employment when he failed to make payment on his account and HESC attempted to garnish his wages from Albany County. On October 24, 2007, HESC was finally advised by Albany County that McDermott was working with a private law firm. Notwithstanding this notice, HESC did not, on that date or at any later time, seek financial documentation from McDermott despite the great probability that he was earning more money in private practice than as a public employee.

The Inspector General reviewed HESC's records regarding McDermott's student loan account with Joseph Bradley, HESC's Director of Regulatory Compliance, and Matthew Downey, HESC's Chief Financial Officer, to determine whether McDermott received special treatment at HESC due to the intervention of Catalano and de Guzman. Preliminarily, Downey and Bradley both confirmed that all actions taken on the McDermott account prior to Catalano's intervention in 2007 appeared appropriate, including the granting of a reduced payment plan. Bradley confirmed that under the

[16] Albany Times Union, *Soares Losing a Steady Hand – Michael McDermott's Departure Raises Questions About Experience in County*, November 4, 2006. The story was picked up by multiple news outlets and reported on local television news programs.

circumstances fully documented in the file, any other borrower with similar financial circumstances as McDermott prior to May 2007 would have been given a reduced payment plan "consistent with policy and regulation." Bradley confirmed that McDermott provided documentation to HESC in support of his reduced payment plan up to and including his 2006 application.

Bradley expressed concern about de Guzman's May 7, 2007 computer entry granting McDermott a continued reduced payment plan. Bradley explained, "The collector at the time [de Guzman] on [the computer entry] stated there is no need for Reasonable and Affordable documents to be submitted and OK'd the borrower for two years of reduced payment." Bradley continued, "There is no regulation to waive the request for documentation and I'm unaware of any HESC policy." Bradley further stated, "I believe the policy has always been that anything more than a year, you would ask for new documentation because there could be changes in the borrower's employment or other expenses that would impact the amount." In fact, McDermott changed employment, as noted above, between his 2006 and 2007 requests for a reduced payment plan.

Consistent with Bradley's assertion, the Inspector General determined that no regulation or HESC policy supported the claim that documentation for a reasonable and affordable payment plan was no longer required as of May 2007 as claimed by de Guzman in her entry in McDermott's account. Inexplicably, however, HESC's "Collections Training Manual" states, "If the monthly reasonable and affordable payment requested is: $50 or greater, meets the monthly interest and borrower shows hardship, documentation is not needed." There is no explanation about how the borrower is capable of showing hardship without providing documentation. As this provision of the manual is inconsistent with federal law and illogical, the Inspector General sought the identity of the author of this section of the manual. While the actual author could not be ascertained, not coincidentally, the Inspector General determined that this provision was placed in the manual and approved by de Guzman at about the same time she was placing a similar incorrect entry in McDermott's computer record as justification for her actions.

While it is not within the purview of the Inspector General to determine the exact payment that McDermott should have made on his student loan, in order to determine whether McDermott received a payment plan to which he was not entitled, the Inspector General obtained W-2 forms and an estimate of expenses for the years 2007, 2008 and 2009 from McDermott.[17] The Inspector General confirmed that McDermott earned substantially more money in private practice than he did working for the Albany County District Attorney's Office. In both 2007 and 2008, McDermott made over $40,000 more in the private practice of law than he did while employed at the District Attorney's Office. In 2009, McDermott also taught a class at an area college and worked in private practice making $188,196.87, approximately $78,000 more than he made at the District Attorney's Office.[18]

The Inspector General solicited the assistance of Frank Brockley, the current HESC Director of Collections, to ascertain whether McDermott should have been granted a reduced payment plan at his income levels in 2007-2009. Brockley compared McDermott's expenses to his income. Many of the expenses that McDermott claimed, Brockley disallowed.[19] Brockley determined that, even given generous expense allowances, McDermott was only entitled to a reduced payment on his student loan from July 2007 to June 2008, as during that period, due to circumstances beyond his control, McDermott was paying mortgages on two homes, which is a legitimate basis for a reduced payment plan. Brockley reiterated his position that many of the other "expenses"

[17] The Inspector General only asked McDermott for documentation of his income. According to federal regulations, spousal income is included in household income to determine a borrower's eligibility for a reduced payment plan. Thus, the income levels used to determine the applicability of a reduced payment plan for McDermott may be artificially deflated.

[18] It should be noted that McDermott fully cooperated in this investigation and voluntarily provided this information.

[19] Brockley stated that there was a subjective component to negotiations between HESC and a borrower regarding a reduced payment plan. Not all HESC collections employees agreed on what was a reasonable expense. For example, Brockley disallowed McDermott's payment for private high school and multiple gym memberships, and reduced McDermott's allowance for a cell phone plan. Brockley allowed payment on a credit card and cable television. Brockley stated that all collections employees should allow home mortgages, food, car, child support, insurance, utilities, and similar such payments as necessities. After the Inspector General's investigation, in order to reduce the level of subjectivity in the process and to increase consistency, Brockley removed the review of applications for reduced payment plans from rank-and-file collectors. All reviews are now conducted by a Senior Accountant on Brockley's staff.

that McDermott had claimed were not necessities and that if he were reviewing the account today, he would not allow a reduced payment during any of the four years in question.

The Removal of Collection Costs

In October 2007, de Guzman and McDermott spoke again after McDermott failed to make required payments in May and September 2007. Neither party to the telephone call was able to remember the catalyst for discussing collection costs, but both admitted that the subject was discussed. Subsequent to this discussion, on October 23, 2007, de Guzman made the following entry in HESC's computer system:

> ALSO DISC COLL COST. B VOL PAYES YEARS. ASK FOR COLL COST. B HAS BEEN VOLUN PAYING - REMOVE COLL COST

This entry translates from HESC jargon as: "Also discuss collections costs. Borrower voluntarily pays for years. Ask for collections costs. Borrower has been voluntarily paying. Remove collection costs."

According to de Guzman, she removed the collection costs because McDermott raised the issue and Catalano approved the action. She admitted that the entry indicates that McDermott had been voluntarily paying for years. When asked if that was a truthful entry, de Guzman admitted that her entry was false, testifying "Well, no, because he hasn't been paying for years – he's missed payments, yes." In fact, McDermott had missed the previous month's payment. Later in her interview, de Guzman became concerned about her admission of making false entries in HESC's records and attempted to defend her entry based upon an untenable semantic argument by claiming that when McDermott actually made payments they were made "voluntarily", in contrast to payments obtained through garnishment. Ironically, in addition to the fact that McDermott repeatedly missed payments, the very reason McDermott was not in garnishment was because de Guzman, her subordinates, or Douglas improperly removed

McDermott from that status. De Guzman admitted that there was no legal basis for any of her actions, but averred that she was effectuating the directions of her boss, Catalano.

For his part, McDermott claimed that it was his understanding that collection costs were discretionary and HESC could waive them if it chose to do so.[20] McDermott stated that de Guzman offered to remove the collection costs because he was paying at least the interest on a monthly basis. Regardless of his actual knowledge of HESC's discretion to lawfully remove collections costs, McDermott had to know that this justification for removing the costs was invalid as he repeatedly missed payments altogether. In fact, the reason he and de Guzman spoke on the telephone in October 2007 was because McDermott had failed to make his September payment. Moreover, McDermott, a lawyer with over 15 years of experience, signed a repayment agreement with HESC in May 2007 in which he agreed to pay $400 per month for one year which included interest *and collection costs*.

The Inspector General discussed de Guzman's removal of collection costs on the McDermott account with HESC officials Bradley and Downey. Both men informed the Inspector General that there was no lawful basis to remove the collection costs. Bradley explained that if a borrower began making payments within the first 60 days after the loan was purchased by HESC and continued to make payments, collection costs may be waived. Downey stated that the only other basis for removing collection costs from an account is if the account is paid in full as part of a settlement and compromise. Neither situation remotely applied to McDermott.

With regard to de Guzman's entry that McDermott had been voluntarily paying, Downey noted that contrary to McDermott voluntarily paying, "We had actually gone through the income execution with the sheriff, garnished his wages when the judgment was in place. HESC subsequently vacated the judgment at McDermott's request, because

[20] To the extent that HESC had the discretion to waive collection costs, those limited circumstances were not applicable to Michael McDermott; McDermott was not involved in a compromise and settlement of his account nor was he involved in a payment plan which commenced within 60 days of default under which he made faithful and consistent payments.

McDermott agreed to consolidate his loan; which McDermott failed to do." Both Bradley and Downey confirmed that McDermott missed numerous payments after HESC vacated the judgment. Further, McDermott did not pay off his account. In fact, remarkably, McDermott's account has been with HESC for over 20 years, yet he has never made a voluntary payment against principal.

To date, McDermott continues to be afforded reduced payments ($400 per month), despite earning an additional $78,000 in 2009 above his 2005 income. McDermott missed multiple payments between 2007 and 2010, but continues to enjoy the benefit of not having collection costs applied to his account. Between November 7, 2007, and August 6, 2010, McDermott failed to pay $2,111.35 in collection costs directly attributable to his loan payments. This number, however, is misleading. Collection costs are only assessed if a payment is made, so this figure is artificially deflated because McDermott missed payments and was not required to make up those payments. McDermott was also permitted to make reduced payments in the amount of $400 per month rather than the $1,030 monthly that was due in 2007, 2008 and 2009. If McDermott had made payments consistent with his promissory note, either voluntarily or through wage garnishment, he would have paid collection costs in the amount of at least $4,225.49 based on the revised payment plan prepared by Brockley.[21] According to Brockley, between November 7, 2007, and August 6, 2010, McDermott should have made at least $26,430 in payments on his student loan. McDermott only paid $13,030 during that period, less than half what was appropriately due.

[21] As noted, under the revised payment plan, Brockley stated that at most McDermott would have been permitted to make reduced payments during the period when McDermott was making mortgage payments on two houses.

Catalano Intercedes on McDermott's Behalf Allowing McDermott to Avoid Wage Garnishment

McDermott's account was removed from wage garnishment[22] at least six times from May 2007 to October 2008, bringing his account current and removing any delinquency or past due payments that accrued after May 2007. An account is "brought current" when delinquency or past due payments are cleared from the account and the borrower permitted to commence repayment anew. The appropriate process to bring an account current is for the borrower to make the past due payments. Although HESC collectors have the authority to make a manual entry on the computer system to bring an account current without payment being made, this usually occurs only when a borrower is legitimately entering into a repayment plan, not when the borrower periodically fails to make a payment as was the case with McDermott.

De Guzman personally removed McDermott from garnishment or ordered that his account be brought current to avoid garnishment on at least five occasions. Mattie Douglas, another subordinate of Catalano, brought McDermott out of garnishment at least once. Allegedly, McDermott was unable to make even the reduced $400 payment he was unlawfully granted on all of these occasions.

McDermott admitted to the Inspector General that he missed payments, even when the payment amount was reduced by de Guzman, and that he would contact her in those instances, relating that, "[D]uring the number of years I've been dealing with Ms. de Guzman there've been a couple occasions where I've missed a payment, I've called Ms. de Guzman and she's like, 'OK, make sure you make the next payment.'" When the Inspector General asked de Guzman why she continued to bring McDermott's account current, she related a conversation she had with Catalano, "I said 'Joe listen, he missed a payment' . . . "I go, 'What do you want me to do, bring him current so to stop the AWG

[22] Wage garnishment occurs when an employer is required by court order or other legal process to withhold a portion of an employee's wages to pay an employee's debt. The debt may be for taxes, a private debt, or a student loan. For further information on wage garnishment, *see* http://www.dol.gov/compliance/guide/garnish.htm.

[Wage Garnishment] because he's already in AWG?' " According to de Guzman, Catalano responded, "Yeah, go do what you have to do."

McDermott was well aware that if he continued to miss payments his wages should be garnished. De Guzman testified to the Inspector General, "I told Mr. McDermott that. I said, 'Look it.' I go, 'At anytime you stop making monthly payments, collections costs is going to go back up. If you stop making payments within 60 days, you're going to be set for AWG [wage garnishment] again.'" Unsurprisingly, due to his continued ability to skirt collections costs and wage garnishment through the intervention of Catalano and de Guzman, de Guzman's threat was never realized. McDermott simply called de Guzman when he missed a payment, his account was brought current, and he was removed from wage garnishment.

De Guzman brought McDermott current twice in 2007, in May and September. In fact, it was after his failure to make his September 2007 payment that de Guzman removed his collection costs. In May 2008, McDermott missed another payment. De Guzman directed HESC employee William Mitchel to bring the account current in May 2008, and then again in June and July 2008 in response to calls from McDermott purporting that he was experiencing financial difficulties. Mitchel confirmed to the Inspector General that he made manual entries in McDermott's account in May, June and July 2008 to bring the account current and avoid both garnishment and past due amounts at de Guzman's direction. Mitchel, who has worked for HESC for 27 years, confided in the Inspector General that in the course of his entire career he knew of no borrower being brought current without making payment for three months, or any borrower being afforded a reduced reasonable and affordable payment for two years, let alone four, without proper documentation.

Catalano Directs a Second Subordinate to Assist McDermott

In October 2008, de Guzman advised Catalano that she could no longer handle McDermott's account as she had been assigned to new duties within HESC. In response, Catalano referred McDermott's account to another subordinate, Mattie Douglas, a Student Loan Control Representative 3 who also served as Catalano's assistant. Catalano e-mailed Douglas on October 3, 2008, about McDermott, directing her to "see me on this." On October 16, 2008, according to telephone records, Douglas made three calls to McDermott's office, the third call lasting over 10 minutes. Two days later, Douglas unlawfully took McDermott out of garnishment and extended McDermott's reduced payment plan. No entry for these changes exists in the case remarks screen of the computer system despite Douglas' protestations that she would have made such an entry. Her actions were automatically captured, however, by the critical change screen and the transaction review screen. Douglas blamed computer error for her failure to place an entry in the case review screen. McDermott testified that he did not recall ever speaking to Douglas about his student loan account.

Despite her previous refusal to work on the account due to her reassignment to other duties, on August 17, 2009, de Guzman again spoke with McDermott. According to contemporaneous entries made by de Guzman in HESC's official records, McDermott told de Guzman that his income and expenses remained essentially unchanged and requested continuation of the $400 payment plan. De Guzman and McDermott purportedly agreed to speak the next day. De Guzman did not record in HESC's records a subsequent phone call. However, on August 24, 2009, de Guzman directed a subordinate to approve a new reduced payment plan for McDermott. The subordinate recorded his conversation with de Guzman in HESC's electronic records noting that de Guzman told him that McDermott's monthly income was $8,150 and his monthly expenses, excluding his student loan, were $7,500. As per de Guzman's direction, her subordinate granted McDermott a reduced payment plan, again in the monthly amount of $400. According to de Guzman's testimony, she obtained the financial information from McDermott. McDermott denied providing this information to de Guzman. Whatever the source of the information, it was false and drastically understated McDermott's income, which by this time was nearly twice the amount entered in the official HESC record.

In January 2010, de Guzman again told Catalano that she would not work on McDermott's account, repeating her explanation that she had been reassigned to other duties. After this time she had no further involvement in McDermott's account, causing Catalano once again to utilize Douglas to work on McDermott's account.

Douglas was highly emotional and defensive when she spoke to the Inspector General. She initially denied having any involvement with the McDermott account until 2010. When confronted with a log of McDermott's account that revealed that she had in fact reviewed and made alterations to the account in October 2008, Douglas became flustered and wept.

Based upon the intervention of de Guzman and Douglas at Catalano's behest, McDermott avoided garnishment at least six times beginning in May 2007. If the account had been placed under administrative wage garnishment, McDermott's employer would have been required to deduct at least the $400 payment on a monthly basis from his wages, and the decision of when and how to make a payment would have been removed from McDermott's control. His only recourse would have been to request an administrative hearing before an administrative law judge to avoid payment. While it is conjecture, it is doubtful that an administrative law judge, taking into account McDermott's income, would have been sympathetic to McDermott's protestations of financial need. Notably, HESC is currently collecting payments on 27,742 loan accounts through garnishment.

Catalano's Role in Granting McDermott Unlawful Benefits

It is clear that de Guzman and Douglas knowingly and unlawfully afforded McDermott advantages to which he was not entitled and which were not available to any other HESC borrower before or since. It is further clear that de Guzman and Douglas took these actions after Catalano directed them to assist McDermott. Despite his vast experience in the field, Catalano disclaimed any improper actions and professed ignorance of the relevant rules and regulations violated at his instigation.

De Guzman testified that after Catalano directed her to “do what you can” for McDermott in May 2007, she looked at McDermott’s account and advised Catalano what options were available, including reduced payments and the removal of collection costs. De Guzman admitted to the Inspector General that she had no legal basis to remove collection costs from McDermott’s account, but claimed that the actions she took on the McDermott account were approved by Catalano.

De Guzman testified and Catalano confirmed that de Guzman kept Catalano apprised of the actions she took on McDermott’s account. For example, in May 2008, de Guzman spoke with Catalano informing him that McDermott had missed another payment and was concerned about the consequences. De Guzman suggested and Catalano agreed that they should bring McDermott current, avoiding both accruing past due payments and wage garnishment, and keep collection costs off the account. McDermott’s account, at the direction of de Guzman, was then brought current three consecutive months in 2008 after he missed payments on his student loans.[23] De Guzman advised the Inspector General that she spoke with Catalano each time McDermott missed a payment and, in response, Catalano mentioned various personal problems that McDermott was experiencing, either divorce or purchasing a home. Interestingly, both Catalano and McDermott claimed in their testimony to the Inspector General that they did not speak with one another during this period.

De Guzman averred that she did not remember speaking with Catalano regarding her actions on the McDermott account in 2009, because the conversation would have been superfluous: “In 2009, why ask? You know what’s going to be told.”

The Inspector General interviewed Catalano on three occasions: twice on the same day and then several weeks later. During his first interview with the Inspector General on March 11, 2010, Catalano, befitting his years of experience, provided the Inspector General with detailed information about processes and procedures for

[23] McDermott’s account was brought current four times in 2008. The fourth time, de Guzman refused to be involved and Catalano referred the problem to Douglas.

reasonable and affordable payment plans, promises to pay, consolidation programs, collection costs, telephone usage, and file documentation, as well as many other HESC programs. His knowledge was substantial and corresponded with his 20-plus years of experience with the agency and 30-plus years in the collections field with HESC, SUNY, and the private collection firm of Solomon & Solomon, P.C. In reviewing numerous files, Catalano readily provided his opinion about whether a particular subordinate took appropriate or inappropriate action under the circumstances reviewed.

During that same interview, Catalano admitted that he spoke with McDermott and directed de Guzman to "take care" of McDermott. Catalano further conceded that de Guzman outlined the steps she was going to undertake on McDermott's behalf. Catalano also confirmed de Guzman's claim he spoke with de Guzman more than once about actions she was taking on McDermott's behalf.

Catalano again met with investigators several hours after his first interview. During his second interview, he again admitted to speaking with de Guzman. Catalano admitted that he said to de Guzman, "He (McDermott) was having financial distress, you know, is there anything you can offer this guy that hasn't been offered before?" Still admitting that de Guzman apprised him of every action she took on the McDermott account, Catalano claimed that he did not understand what de Guzman was saying to him or did not understand the import of her activities. Catalano disclaimed any intention of directing de Guzman to take any improper actions, stating, "Perhaps that choice of words implied to her that, you know, something more than it was, but it certainly wasn't my intention." Catalano further attempted to minimize his knowledge of applicable rules: "I don't get involved with the rules and regulations 'cause that's what they do, they're familiar with them, I am not. I mean, I know that there are rules, I know the broad picture of the rules, but I honestly don't know. You could rattle off a million things, uh, uh, it's like talking Greek to me." Catalano's claims of ignorance, however, are called into question by his wealth of experience and the high degree of detail he displayed regarding collection costs and reasonable and affordable payments several hours earlier in his first interview on March 11, 2010. Additionally, Catalano specifically conceded in his interview that it “wouldn’t be a good thing” for HESC to bring a borrower current who had not made required payments, as was done for McDermott.

While conceding that he discussed the matters with de Guzman, Catalano also alternatively maintained that he was not informed of “the particulars” of what actions de Guzman was taking regarding McDermott’s account. De Guzman directly contradicted this claim. Regarding collection costs, de Guzman testified that she would not “go off the normal stream of things” without “covering [her] butt” and therefore spoke to Catalano and specifically obtained his permission before she turned off McDermott’s collection costs. De Guzman further testified that she informed Catalano of the fact that McDermott continued to miss payments and that she had to alter HESC records to keep McDermott’s account current and keep him out of garnishment on each occasion.

Catalano’s testimony regarding his conversations with de Guzman was not wholly clear or consistent, and, at times, was contradictory. Although claiming at different times that he either did not know the particulars of the actions taken to aid McDermott or that he did not comprehend their meaning, Catalano specifically admitted that de Guzman informed him that McDermott was making “reduced payments.” Catalano further admitted that de Guzman “probably did” talk to him about McDermott’s missed payments but then posited that “it’s not unusual for somebody to miss payments,” and that “there are people that we would have adjusted accounts for based on their circumstances, we do adjust collection costs.”

Catalano also tried to claim that he did not treat McDermott in any special manner and that McDermott was not a special friend. Catalano tried to compare his actions on the McDermott account to the actions he would take on any referral of a disgruntled borrower from the HESC President’s Office. Catalano conceded, however, that the McDermott matter was not a referral from the President of HESC or a member of the general public, rather this was a person who had Catalano’s telephone number, who contacted him directly, and asked for his assistance – and Catalano gave McDermott his assistance.

During his third interview, Catalano claimed that what was done for McDermott would have been done for anyone who called him. Catalano testified, “I do what I . . . I do what I always do . . . I said, I’ll send it up to the program area.” Catalano admitted that if an account or borrower is referred to him or a person calls him directly, he does not send him or her through the normal protocols of the 800 number. He testified:

> We never do that. I mean, I can’t tell you one time anybody’s ever sent me an account or anybody’s written to me personally where I’ve sent them back to the 800 number. And I can guarantee you my boss doesn’t do it and my boss’s boss doesn’t do it. We never do that. . . .

By his third interview, Catalano admitted that he also forwarded McDermott’s account to Douglas on two occasions but now claimed that he never spoke to Douglas about any action she took on the McDermott account. Catalano’s testimony is contradicted by the evidence. Namely, Catalano sent Douglas an e-mail on October 3, 2008, with the subject “Fw: Michael McDermott” stating, “Please see me on this. Joe”. This e-mail was a forward of an e-mail from de Guzman in which she indicated she could no longer take action on the account. Douglas spoke to McDermott by telephone on October 16, 2008, but did not make any changes in McDermott’s account until October 18, 2008. Not coincidentally, after receiving direction from Catalano, Douglas took the same improper actions which de Guzman had previously taken: removing McDermott from garnishment and approving a new $400 reduced payment plan without requesting required financial documentation. It strains credulity to believe that two subordinates of Catalano engaged in the same inappropriate conduct after speaking with Catalano, but that Catalano was wholly ignorant of any preferential treatment afforded. Moreover, given that de Guzman and Douglas are anything but friends, it appears highly unlikely that they discussed the matter and conspired to provide this benefit on their own. The common factors linking their actions are Catalano and McDermott. The results are identical: McDermott was allowed to skip a payment on his student loan and he was given a reduced payment plan without documentation. The only difference was that de Guzman documented her actions; Douglas did not.

The Cost to HESC of the Preferential Treatment for McDermott

Based on the improper reduced payment plan he was afforded, McDermott paid between $13,000 and $16,500 less than was due on his account between November 2007 and August 2010. Absent any reduced payment plan, McDermott would have been required to pay $4,765.13in collection costs. However, McDermott was even excused from paying collection costs totaling $2,111.35 on his underserved reduced payment plan. Moreover, without intervention, these charges would have been directly garnished from McDermott's salary, removing his ability to avoid payment.

HESC Unlawfully Pays $7,150 in Collection Costs for HESC Employee Brian Cox

HESC has implemented two policies regarding employees who have defaulted on their own student loans. The first policy, entitled "Policy for Employees with Student Loan Obligations", prohibits HESC employees from accessing their personal accounts or the accounts of family members. The policy requires that any employee with a defaulted student loan must either be in a voluntary repayment program or placed in administrative wage garnishment. The second policy describes HESC's internal procedures for dealing with employees with defaulted student loans. A designated management representative receives a quarterly report on all HESC employees with loans in the aversion process or loans which have defaulted. The representative meets with the employees and counsels them regarding repayment options. The management representative also monitors employee defaulted accounts and will divert the account into wage garnishment if necessary.

At all times relevant to this report, Jeffrey Hazzard, a Student Loan Control Representative 3, was the management representative designated to manage HESC employee student loan accounts.

Brian Cox's Defaulted Student Loan Account

Brian Cox commenced employment with HESC on June 29, 2006, as a Student Loan Control Representative 1 and continues to serve in that capacity.

A review of Cox's student loan account reveals that within weeks of Cox being hired by HESC, Cox's student loan entered the aversion process, and he agreed to rehabilitate the loan as soon as it defaulted. On February 3, 2007, Cox's student loan went into default and was purchased by his employer, HESC. Cox made his first payment on the account on February 26, 2007. Cox made 10 timely payments on the loan at a properly approved reduced amount of $300 per month. On a quarterly basis, Hazzard noted that Cox was making timely payments. As per his promise, Cox received an application to rehabilitate his loan, applied for loan rehabilitation, and was approved.

When Cox received the application for the loan rehabilitation, he spoke to William Christopher, an HESC supervisor in charge of the rehabilitation program. Cox and Christopher agree they discussed the rehabilitation process, but their accounts diverged when the topic of collection costs, both in-house and rehabilitation, was raised.[24]

Christopher advised the Inspector General that he first became aware of Cox's defaulted loan when Cox approached him and told him he received a letter in the mail indicating he qualified for loan rehabilitation. Christopher claimed that Cox asked about waiving collection costs because he began repayment within the first 60 days of the loan being purchased by HESC. Christopher told Cox that he would look into the matter. Christopher testified that because he had never removed collection costs before for any borrower, he sought the approval of his superior, de Guzman, Director of Collections at the time. Christopher averred that he reviewed the account with de Guzman, verifying

[24] As discussed above, rehabilitation collection costs, as opposed to the "in house" collection costs relevant to McDermott, refer to the costs imposed on a borrower whose loan is rehabilitated (purchased by a second lending institution).

that Cox began making payments within the first 60 days and was making monthly payments. Christopher stated it was his intention to waive both in-house and rehabilitation collection costs.

De Guzman confirmed that Christopher spoke with her about the collection costs on Cox's account. Because of the nature of the transaction proposed by Christopher, de Guzman stated that she needed approval of her supervisor, Catalano. De Guzman testified that she informed Catalano, "This is the situation – and [Catalano] said 'Oh, he works for us', and I removed the collection costs." De Guzman admitted that she intended to waive both in-house and rehabilitation collection costs on the Cox account, but that she was unaware of the steps necessary to waive rehabilitation collection costs.

Catalano denied all knowledge of the Cox account and denied speaking to de Guzman about Cox's collection costs. Undermining Catalano's denial, the Inspector General was informed by numerous witnesses that Cox's arrangement was widely known within HESC so it appears unlikely that Catalano would remain ignorant of the matter.

Cox signed an Acknowledgement of Debt for Rehabilitation of Defaulted Student Loans, a document which acts as a promissory note on the rehabilitated loan, on October 30, 2007. On that form, Cox agreed to pay 18.5 percent collection costs of $7,179.48.[25] Despite Cox's agreement as formalized on the form he signed, Christopher acknowledged that he expected the collection costs to be removed from Cox's account. Christopher stated that when he turned off the collection costs on Cox's account, he believed that he waived both the in-house and rehabilitation collection costs.

The HESC computer system accepted the waiver of in-house collection costs and did not assess the costs on Cox's November and December 2007 payments. Problems arose, however, when Christopher tried to waive the rehabilitation collection costs Cox was due to pay. As removal of these costs had never been done before for any borrower, HESC's computer system was not programmed to perform this function and Christopher

[25] The amount of collection costs on the form was estimated.

was prevented from making the necessary entry in the computer system. Christopher therefore sought assistance from Ashanti Henry, a Senior Accountant. Henry, who stated the transaction was unusual, testified, "I will not forget this. Only because at the time I asked a lot of questions – just to make sure – I'm going to cover my ass." According to Henry, Christopher told her that de Guzman ordered that the costs be waived.

Henry stated that because Cox commenced payment within the first 60 days of default and never missed a payment, in-house collection costs should have been waived while the account was held by HESC. Henry was unaware of any other situation (except in the case of a judicial order or stipulation settling a lawsuit) where rehabilitation collection costs were waived, except Cox. "This was different," she added. Indeed, it was so novel, that HESC's computer program could not process the transaction.

Henry explained that she conferred with Donald Dugan, HESC's Director of Collections Support and Federal Reporting, regarding how to handle the situation. Evincing the unprecedented nature of HESC seeking to remove rehabilitation collections costs from a borrower's account as reflected in the inability of their computer system to process the transaction, Dugan told Henry that in order to do so, HESC would be required to take the remarkable step of issuing a check to the private lender to cover the rehabilitation collection costs. Henry stated that it was not Dugan who decided to waive the collection costs; he merely devised a means of accomplishing that goal.

Cox's loan was rehabilitated on December 19, 2007. Even though Cox's rehabilitation lender initially paid HESC for rehabilitation collection costs on the loan, on January 23, 2008, HESC sent a check to the lender for $7,150.80 to cover Cox's collection costs. [26] The transaction history file notes the payment and states "waived CC"

[26] The Inspector General interviewed Warren Wallin, HESC's Chief Financial Officer at the time the $7,150.80 check was written for the rehabilitation collection costs. Wallin stated that once the check was approved by Henry and her supervisor Dugan, there was no procedure at HESC to "double check" on the propriety of the payment before it was sent. The check amount was below the normal threshold for a second signature and was a transfer to a bank. HESC transfers hundreds of thousands of dollars to banks on student loan accounts on a daily basis. The single signature on the account was a facsimile signature affixed in the normal course of business for checks to institutions for miscellaneous payments under $100,000.

or as explained to the Inspector General, "waived collection costs." The check advice states "refund collection costs for a/c # [Cox's social security number]."

De Guzman and Christopher denied any knowledge that a check was issued to cover Cox's collection costs. Despite the fact that Henry stated that she issued the check at de Guzman's direction, de Guzman claimed that she did not have the authority to direct that a check be written to cover rehabilitation collection costs.

Cox's version of events regarding the collection costs is drastically different from Christopher's account. Cox denied knowledge of the fact that his collection costs were waived by HESC. Cox acted befuddled when shown a copy of his account and directed to the entries where the in-house collection costs were removed and where a check was issued to his lender to cover assessed rehabilitation collection costs. Cox denied asking to have collection costs removed adding, "I would have no reason to. I was well aware of what happened with my loan going into default status. I was ready to take responsibility for the fact that it went into default status. I have no reason to even consider collection costs being removed." Cox reaffirmed, "I definitely did not request that collections costs be removed." Cox claimed he was "completely unaware" that HESC paid $7,150.80 to his lender for collection costs. Cox claimed that he never tracked the balance of his loan, either before or after the loan was rehabilitated. He further claimed that he never noticed that the principal amount of his rehabilitated loan was approximately $38,000 rather than approximately $45,000, the amount that was due according to his Acknowledgement of Debt for Rehabilitation of Defaulted Student Loans. Cox stated, "I got to be honest with you I never – I made payments – and then shortly after I stopped making payments – I wasn't even watching my account."

Notably, in violation of HESC policy, the Inspector General determined that Cox not only "watched" his HESC account, but that Cox accessed his account despite HESC policy to the contrary and updated some personal information. While the entry appears harmless, it was clearly improper. Cox claimed ignorance of any policy prohibiting him from accessing his account.

In a follow-up interview, Christopher was told that Cox flatly denied speaking to anyone at HESC about collection costs. Christopher replied, "That's not true." Christopher opined that the reason Cox got his collection costs paid for by HESC, unlike every other borrower in the agency's history, was, "[Cox] asked me. I think he's a very hard worker. I believe he gets the same opportunity as the other person gets. If he didn't ask me, I wouldn't have asked the Director to turn them off." Christopher repeated that he treated Cox the same as he would have treated anyone else who got in touch with him, but also averred that no one else ever asked. Christopher confirmed that Cox had worked for HESC for a very short time when his loan was rehabilitated. Christopher claimed he did not know Cox outside of work and had no interest in doing Cox a favor.

Cox's claim of ignorance regarding the waiver of collection costs on his account is unconvincing. It is simply not believable that Cox did not notice that he was billed over $7,000 less on his rehabilitated loan than what he acknowledged as due on his rehabilitation application. The Inspector General, therefore, spoke with the Principal Accountant who oversees the rehabilitation unit, Debra Mead. Mead is a close personal friend of Cox. Mead initially stated that she never heard of anyone having rehabilitation collection costs waived. Then she corrected herself, directly contradicting Cox, and said, "I do know that those collection costs for Brian [Cox] were waived because, I believe, he told me that after it was done. I know nothing about how it happened or whatever. And no, I don't know of it happening to any other rehabilitation loan."

While the Inspector General does not fault Cox for inquiring into the waiver of collection costs, – in fact, for in-house collection costs Cox may have been correct to have them removed[27] – Cox cannot be excused for providing untruthful answers about

[27] Prior to January 1, 1998, in-house collection costs were required by the federal regulations but not enforced. Some time in 1997, the United States Department of Education advised all guarantee agencies that it was going to apply collection costs to all payments received from borrowers unless there was some type of exception. From January 1, 1998 forward, payments would be credited first to collection costs, then to interest, then to principal. On July 28, 1997, the Department Education identified one exception to the mandatory application of collection costs: when a borrower enters into repayment plan within 60 days of default and makes acceptable payment thereon by the required due date. During this investigation, HESC employees repeatedly advised the Inspector General that HESC did not impose collection costs under the payment plan scenario outlined by the Department of Education on July 28, 1997. Several employees provided the Inspector General with the same letter outlining the exception. During its investigation,

the transaction. Cox told investigators that he had no idea that collection costs were removed from his in-house account and paid for him upon his loan's rehabilitation. That assertion is contradicted by the overwhelming evidence that Cox asked for the waiver of collection costs and knew that it had been approved. Indeed, apparently everyone in the Collections Unit at HESC knew about the special treatment afforded Cox.

Collection Costs Required on Rehabilitated Loans Under Federal Law

The Inspector General inquired into whether any borrower other than Cox ever had his or her rehabilitation collection costs paid by HESC. No one at HESC was able to provide a single record of another instance where rehabilitation collection costs were waived or paid for by HESC.

Based on Henry's testimony that Dugan developed the unprecedented mechanism for waiving Cox's rehabilitation collection costs (the state issuing a check to a private lender), the Inspector General interviewed Dugan. Initially, Dugan conceded that, "the only time that we would pay a rehabilitation lender is if for whatever reason the rehabilitation should not have been done." Dugan acknowledged, however, that Cox's loan was properly rehabilitated. Dugan denied any knowledge of, or involvement in, the waiving of collection costs for Cox. He confirmed, however, that the only way HESC could have paid for the rehabilitation collection costs would have been through manual intervention. Contradicting his testimony, e-mails obtained during the Inspector General's investigation revealed that Dugan participated in the decision to issue the check and, in fact, demonstrate that it was Dugan's idea to do so.

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however, the Inspector General, working with HESC staff, was only able to find a single instance, that of Brian Cox, where collection costs were turned off because the borrower entered into a repayment plan within 60 days of purchase. In every other instance where collection costs were turned off, other than for McDermott, the borrower had entered into a compromise and settlement of the account. There appeared to be a disconnect between HESC's practice as it was described to the Inspector General and the implementation of that practice in HESC's computer operating system. HESC revised its computer operating system in the fall of 2009 and collection costs are currently being waived for borrowers who enter into a repayment program within 60 days of default and make continuous on-time payments. HESC has not decided what course of action it will take regarding defaulted accounts between 1998 and 2009, if any. HESC and the Department of Education are in discussions about the matter.

While the issue of whether in-house collection costs may lawfully be waived by HESC is currently under review,[28] it is incontrovertible that HESC lacks the authority to waive rehabilitation collection costs under federal law. Federal regulations require collection costs on rehabilitated loans.[29] Accordingly, HESC policy requires collection costs on rehabilitated loans and HESC's forms and notices advise borrowers that collection costs will be applied to rehabilitated student loans. Further, the application for a loan rehabilitation, like the one signed by Cox, includes a computation of collection costs and requires that the borrower promise to pay that amount as capitalized principal on the rehabilitated loan. Current and former members of HESC's management confirmed that all rehabilitated students loans, from the inception of the program, have included collection costs. Without a doubt, Cox's rehabilitation collection costs should not have been paid by HESC.

Ethical Implications of Unwarranted and Unlawful Benefits Provided McDermott and Cox

In addition to potential criminal charges related to the entering of false information in official records, official misconduct, and larceny of state funds, the state's ethics guidelines contained in Public Officers Law § 73(3) provide, in relevant part:

> d. No officer or employee of a state agency, member of the legislature or legislative employee should use or attempt to use his or her official position to secure unwarranted privileges or exemptions for himself or herself or others, including but not limited to, the misappropriation to himself, herself or to others of the property, services or other resources of the state for private business or other compensated non-governmental purposes.
>
> f. An officer or employee of a state agency, member of the legislature or legislative employee should not by his conduct give reasonable basis for the impression that any person can improperly influence him or unduly enjoy his favor in the performance of his official duties, or that he is affected by the kinship, rank, position or influence of any party or person.
> h. An officer or employee of a state agency, member of the legislature or legislative employee should endeavor to pursue a course of conduct which will

[28] See footnote 27.
[29] 34 CFR 682.405(b)(vi)

> not raise suspicion among the public that he is likely to be engaged in acts that are in violation of his trust.

McDermott and Cox were undeniably afforded unwarranted privileges unavailable to any other borrower. The Inspector General, therefore, is referring these findings to the Commission on Public Integrity, the state agency charged with adjudicating violations of the state's ethics laws.

HESC Employee Donald Traver Alters HESC Records and Interferes with Collection of Student Loans

Commencing in late 2008, HESC began a reorganization and computer upgrade which changed many job assignments of HESC employees. Certain employees felt threatened by the changes and became concerned for their jobs. The thrust of their complaint was that Catalano was giving their work away to outside collection vendors.[30]

Donald Traver is a Student Loan Control Representative 2. Until August 2008, Traver supervised staff in the collections area at HESC, and he continued to take incoming collection telephone calls until the end of 2009. Traver currently supervises staff in the aversions area. Until 2010, Traver also supervised clerical staff performing support functions for both the collection and aversion operations.

Traver's False Entries in HESC's Computer System

On April 2 and 3, 2009, Traver made unusual computer entries on the DMCS system in regard to 31 defaulted student loan accounts, most of which had been in HESC's possession for over a year. Traver made entries in three accounts on April 2 and in 28 accounts on April 3. Specifically, Traver targeted the largest accounts at HESC scheduled to be sent to outside collection vendors. The entries stated "BC" and "PP"

[30] The Inspector General will not comment on the propriety of the decision to retain collection vendors by HESC but notes that: 1) HESC makes a "profit' on every collection dollar brought into HESC by a collection vendor, and 2) every HESC employee interviewed regarding this report, including Traver, recognized that collection vendors are a necessary component of HESC's collection efforts.

with no further elaboration. In HESC jargon, BC stands for "borrower contact" and means that the person making the entry spoke to the borrower. The PP notation stands for "promise to pay" and means that the borrower promised to make a payment to HESC on a specific date. A promise to pay entry automatically stops the referral of an account to a collection vendor. The promise to pay entry also generates an automatic letter to the borrower advising the borrower of his promise to pay.

The Inspector General first sought to determine whether Traver had actually spoken with these borrowers as he indicated in official HESC records ("BC"). The Inspector General obtained telephone usage records for Traver's telephone on April 2 and 3. On April 2 there were 13 outgoing calls, four of which went outside the state's internal Capnet system,[31] and two incoming calls. On April 3, there were only four incoming and seven outgoing calls. Of the seven outgoing calls, only one extended beyond the Capnet system. The Inspector General then compared Traver's telephone usage to the contact information for all 31 accounts he altered. None of the contact telephone numbers for any of the borrowers were telephoned by Traver — five of the accounts did not even have a contact telephone number listed in HESC's records. Therefore, contrary to Traver's official entries in HESC's computer system indicating that he contacted these 31 borrowers, there was no evidence he had done so.

On April 6 and 7, Traver directed two Student Loan Control Representatives to issue consolidation applications to the 31 borrowers. One of the Student Loan Control Representatives working at Traver's direction stated that only some of the accounts qualified for consolidation. This HESC employee told the Inspector General that she noticed questionable entries on the accounts referred to her by Traver and confronted him about them. According to the employee, Traver said, "Joe Catalano is trying to take our jobs and refer them to the vendors" and declared that he was doing this to save jobs at HESC. The employee remained concerned about Traver's actions and reported it to her supervisor, Mattie Douglas. Douglas confirmed that she was advised of the fraud and

[31] Capnet is the internal New York State government telephone system serving the Albany area.

that shortly thereafter she referred it to HESC's then-Senior Vice President Elsa Magee who appropriately referred this matter to the Inspector General.

After Traver spoke with the aforementioned employee, he became concerned about his actions and spoke to Beverly Berghela, who at the time was a mid-level supervisor in HESC's Collections Unit. Several years earlier she had been Traver's supervisor, and the two had remained friendly. Both Berghela and Traver told the Inspector General that he advised Berghela of the entries he placed in HESC's records regarding the 31 accounts and that she told him that he could not place a promise to pay on an account if he did not speak to the borrower. Berghela admitted that she told Traver to remove the promise to pay indicator and to pull the promise to pay letters so that they would not be mailed out to borrowers. Traver testified that Berghela told him not to touch the accounts.

Despite Berghela's direction that Traver make no further entry in the accounts, on April 7, 2009, Traver ordered a member of his clerical staff to make an entry in all 31 accounts which read as follows:

PILOT PROJECT PROMISE TO PAY LETTER SENT IN ERROR.

Traver also ordered a mail clerk to remove the promise to pay letters automatically generated as a result of his prior false entries and place them in the shredding bin. The mail clerk did so. The consolidation letters, for those of the 31 accounts to which consolidation was applicable, were mailed. None of the 31 accounts have applied for a loan consolidation to date.

The Inspector General interviewed Traver. Traver admitted that on April 2 and 3, 2009, he identified the largest collection accounts[32] about to be referred to a vendor and entered a promise to pay on HESC's system without contacting the borrowers. Traver

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[32] Traver used Enterprise Guide Access which enabled him to identify accounts that fit certain parameters. The Enterprise Guide Access is a licensed information source used by a limited number of staff at HESC.

advised the Inspector General that he wanted to solicit large accounts for consolidation. He further admitted that he entered a promise to pay notation on the accounts to hold the accounts within HESC rather than refer them to a vendor purportedly so that the borrowers would have time to consolidate the loans while they were still in-house at HESC. Traver stated that he believed that referring collection work to outside collections vendors could result in the reduction of staff at HESC.

Traver admitted the entries he made on the 31 accounts were false as he never had any contact with any of the borrowers. Traver confessed that, "These were to save accounts from going to collection agencies that had a high balance and to do that you had to put a PP . . . by my putting the PP there was not a valid entry. . . ." Traver also acknowledged that although Berghela told him not to make further entries into the accounts, he ordered a clerical employee to make further false entries on April 7 alleging that the promise to pay letters were sent in error. Traver admitted that he gave the order to "protect himself." Traver also admitted directing another staff member to shred the promise to pay letters created by his fraudulent entries.

Traver attempted to explain his actions by claiming that he was conducting a personal "pilot" or test program in which consolidation would be used as a collection tool rather than sending accounts to outside collection vendors. He further claimed that if his idea worked, he would have informed upper management of his actions. Traver's defense defies belief . Traver admitted that he never advised anyone in management or requested permission from any manager to conduct a personal pilot program or to enter false data in the DMCS system, or to divert collections accounts from outside collection vendors. Traver admitted that he did not have the authority to unilaterally engage in a pilot project without management's approval.

At the time of Traver's fraud, the 31 accounts were worth over $1.25 million. His actions delayed, and in most cases obstructed, HESC's collection activities. Subsequently, between July 2009 and February 2010, HESC referred 25 of the 31 accounts to collection vendors. Of the six remaining accounts, HESC continues its own collection activities on four accounts, one account has been rehabilitated, and one account has been recalled by the U.S. Department of Education.

IV. FINDINGS AND RECOMMENDATIONS

The McDermott Account

The Inspector General determined that at the instigation of Joseph Catalano and the direct intervention of Dantaida de Guzman and Mattie Douglas, Michael P. McDermott obtained four years worth of improper reduced payment plans on his student loans without required documentation. For most of the time, McDermott was not entitled to the reduced plans based on his income and expenses as required by federal regulation and HESC policy, and he received that reduced payment plan solely due to his acquaintance with Catalano. The Inspector General further determined that McDermott was illegally excused from paying required collection costs on his student loan due to the intervention of Catalano and de Guzman. The Inspector General further determined that McDermott repeatedly failed to make payments on his student loan account; yet, McDermott's account was repeatedly brought current to keep him out of garnishment and to avoid past due payments. He received this preferential treatment solely due to his acquaintance with Catalano.

The Inspector General determined that de Guzman made false entries in the official HESC record to facilitate the special privileges given McDermott at Catalano's direction

The Inspector General recommended that HESC immediately review the McDermott account and apply a payment rate consistent with federal law and take any and all action to obtain delinquency payments and collection costs owed by McDermott.

The Inspector General recommended that HESC take appropriate disciplinary action against Catalano, de Guzman, and Douglas.

The Inspector General recommended that HESC review its training manuals and policies to ensure compliance with state and federal law and regulations concerning student loan collection practices.

The Inspector General has forwarded this matter to the New York State Attorney General's Office for consideration of possible criminal action.

The Inspector General further is referring this matter to the New York State Commission on Public Integrity for its review of potential violations of the state's ethics law by Catalano, de Guzman, and Douglas.

The Cox Account

The Inspector General determined that Brian Cox improperly received $7150.80 from HESC in the form of payment of his rehabilitation collection costs on his student loan. Cox is the only person to ever receive this benefit from HESC. Cox received this benefit solely because of his inside knowledge and employment at HESC.

The Inspector General determined that Cox provided untruthful testimony to investigators during the course of the investigation in an attempt to avoid liability for the improperly paid collection costs.

The Inspector General further determined that de Guzman and Donald Dugan acted in violation of federal law by directing the payment of HESC funds for the benefit of a HESC employee.

The Inspector General recommended appropriate discipline for Cox, de Guzman and Dugan.

The Inspector General recommended that HESC take any and all action necessary to recover the illegally paid rehabilitation collection costs from Cox.

The Inspector General has forwarded this matter to the Attorney General of the State of New York for consideration possible criminal action.

The Inspector General further is referring this matter to the New York State Commission on Public Integrity for its review of potential violations of the state's ethics law.

Donald Traver

The Inspector General determined that Donald Traver made false entries in 31 accounts maintained as part of HESC's official records.

The Inspector General further determined that Traver ordered subordinates to make additional false entries on the same accounts to hide his actions, and directed other subordinates to destroy the correspondence produced by the computer system as a result of his actions.

The Inspector General recommended that HESC take appropriate disciplinary action against Traver.

The Inspector General has forwarded this matter to the Attorney General of the State of New York for potential criminal action.

Response of the Higher Education Services Corporation

The response by the Higher Education Services Corporation to the Inspector General's findings and recommendations is attached.

August 6, 2010

Inspector General Joseph Fisch
Office of the Inspector General
Empire State Plaza
Agency Bldg. 2, 16th Floor
Albany, New York 12223

Dear Inspector General Fisch:

I am in receipt of your report of investigation into allegations of improprieties on the part of HESC employees in the administration of certain defaulted loan accounts. HESC very much appreciates your assistance and the effort expended by your staff in conducting a thorough and diligent review of the matters originally identified and referred by HESC, as well as additional matters that came to the attention of your office during the course of the investigation.

HESC takes extremely seriously its obligations as a guarantor in the Federal Family Education Loan (FFEL) program, in particular, its obligation to administer programs in a fair and consistent fashion according to applicable laws and regulations. The Inspector General's report of investigation clearly establishes that certain HESC employees failed to meet this standard. The conduct described is unacceptable to HESC management, as well as to the hundreds of HESC employees who perform their duties on a daily basis in a fair, equitable and lawful manner. The FFEL program provides HESC and borrowers with many tools to help students manage their student debt consistent with the borrower's financial means. It is fundamentally unfair to provide advantages to individual borrowers not available to all borrowers based on position and personal relationships.

HESC will, as recommended, pursue appropriate disciplinary action against all employees identified as having engaged in improper conduct and concurs that the conduct described in the report warrants full review by the Attorney General and the Commission on Public Integrity.

On behalf of HESC, I want to express my thanks for the professional and cooperative manner in which the investigation of these serious allegations was conducted. The agency will be taking appropriate steps to help ensure that such conduct is not repeated.

Sincerely,

Elsa Magee

Elsa Magee
Acting President

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