

**Conference Call on Voluntary Flexible Agreements (VFA)
June 13, 2011**

**Questions and Answers
Posted June 27, 2011**

The following are written responses to questions that were presented and responded to by Department of Education (ED) staff during the June 13, 2011 VFA conference call with FFEL Program guaranty agencies. Although the substances of the questions and answers have not been changed, the text paraphrases the actual responses provided on the call and therefore may be slightly different. In some instances additional information has been added to help clarify the original response. A recording of the June 13 call is available on ED's Financial Partners Portal at <http://www.fp.ed.gov/VFA.html>.

The ED participants on the call were:

Jim Runcie, Federal Student Aid
Jeff Baker, Federal Student Aid
Jay Hurt, Federal Student Aid
David Bergeron, Office of Postsecondary Education
Brian Siegel, Office of the General Counsel
William Graham, Budget Services

Q1: There are no revenues directly associated with two or three of the proposed GA Responsibility Areas, is ED suggesting revenues will be provided for these responsibility areas?

A1: Jay Hurt – Yes. Since the VFAs must, in the aggregate, be cost neutral we expect economies of scale from proposed changes in the current cash flows from activities related to GA Responsibility Area I (Claims and Collections) to provide resources for the other GA Responsibility Areas. [Posted June 27, 2011]

Q2: Is it the Department's desire to establish common pricing and standardized procedures for each guarantor function through the VFA negotiation process?

A2: Jay Hurt – No, while we are looking for a standard payment methodology, we are not necessarily looking for common pricing and standardized procedures. [Posted June 27, 2011]

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Q3: Will the fees paid for each GA Responsibility Area be consistent among the VFAs?

A3: Jay Hurt - We are looking to move toward a standardized payment methodology and will use the review of the VFA proposals submitted by the agencies to come to that result. [Posted June 27, 2011]

Q4: How will cost neutrality be determined?

A4: William Graham - The statute requires that the cost of the FFEL Program with the VFAs, not exceed the cost of the program without the VFAs. We will be looking at the totality of costs related to the FFEL Program to ensure that the baseline costs of the program under the VFA does not exceed the cost of the FFEL Program today. [Posted June 27, 2011]

Q5: Will credit be given to reduced federal costs (e.g. through reduced defaults or increased collections)?

A5: William Graham - In general we will be looking at changes in the specific cash flows or fee payments to the guaranty agency's themselves. However under very limited circumstances, if we can document and measure other changes within the FFEL Program, we may be able to adjust our calculation using those changes. For example, if there has been a pilot program running for some time that has the effect of reducing default costs, and if that can be measured, savings related to those reduced costs may be able to be included in the determination of the cost neutrality of the VFAs. We won't know the answer to those questions until we actually see the proposals. We're looking at the totality of costs. The VFAs have to be reviewed annually under the construct we have here to ensure continuing cost neutrality. [Posted June 27, 2011]

Q6: What happens if, during quarterly monitoring, ED determines that due to performance of one of the VFA's, or external factors (e.g. an economic downturn that increases defaults), some of the original cost neutrality assumptions have changed?

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- A6: William Graham - External factors that are outside of the VFA construct won't necessarily impact the cost neutrality calculation. If there is an economic downturn that will impact the baseline and the VFA structure the same there will not be an impact. What might potentially have an impact is if the VFAs do not operate in the way we anticipated when we determined the original cost neutrality. We will review the VFAs annually and if they are not cost neutral we may have to make adjustments. [Posted June 27, 2011]
- Q7: Are all loans under a VFA intended to be 100% reinsured?
- A7: Jeff Baker- Frankly we had not considered that at all in putting the proposal together. The proposals have very little to do with the specifics of loan guarantees and related aspects of the FFEL Program, it's the structural way that guaranty agencies do business that we are looking for in the proposals. But we're not excluding anything, particularly if you can find the kinds of savings needed for cost neutrality and for other purposes. [Posted June 27, 2011]
- Q8: If a GA participates in a VFA, will it lose its current state designation?
- A8: Brian Siegel - Statutory changes to the FFEL Program have effectively eliminated the importance of state designation of a guaranty agency for federal purposes. However, we understand that these designations may have some significance at the state level and we do not intend to change or modify current State designations of guaranty agencies. [Posted June 27, 2011]
- Q9: For GA's that have selected the same GA Responsibility Areas, how will volume allocations be determined? Will allocations be based on state designation?
- A9: Jeff Baker - We're going to wait until we see the proposals. We are hopeful that the proposals that come in either from teams or individual agencies will help guide us in terms of how much volume for loans in GA Responsibility Area 1 (Claims and Collections), for number of lenders in GA Responsibility Area 4 (Lender Oversight), and in service area for the other two GA Responsibility Areas. We are committed to ensuring that we end up with national coverage. Obviously all of the FFEL Program loans out under guaranty have to remain guaranteed and lenders have to be assured that their claims will be reviewed properly and paid. For the taxpayer, all collection activities must be maintained with no gaps. Our objective is to have national coverage in the areas of outreach oversight and default prevention and aversion. One of the reasons why we will work with the GA on serious proposals but suggest some tweaking here or there is to fill some gaps if we do not get exactly the coverage we need. [Posted June 27, 2011]

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Q10: Will ED ensure that GA's participating under a VFA receive sufficient revenue to allow the agency to continue to operate under the VFA? If so, will this in effect create a subsidy to certain GAs which other GAs would not be entitled to receive?

A10: Jay Hurt - The continued viability of GAs is very important to us. We expect the GAs to propose VFA models that will improve their long term business viability. [Posted June 27, 2011]

Q11: Under what "limited circumstances", if any, will ED approve income under a VFA to be shared between agencies?

A11: Jay Hurt - There is a distinction between payment and income. All payments to and from each individual agency under a VFA will go through the Department. That said, we are looking for teaming arrangements that might suggest better cost neutrality or improved cash flows. While payments will flow to and from the Department, income from one activity within a teaming arrangement may be used to fund costs for another activity within that teaming arrangement. [Posted June 27, 2011]

Q12: The invitation states that GA's cannot make payment to one another. Does this statement cover vendor arrangements (e.g. servicing system costs)?

A12: Jay Hurt - No, the GA will continue to pay their servicing systems or their sub-contractors through their contract arrangements. [Posted June 27, 2011]

Q13: Agencies often can utilize state tax offset, lottery offset and state vendor payment offset as additional tools to collect defaulted loans. These agencies also have access to state motor vehicle and other databases that improve default recoveries. Reducing the number of GA's and transferring the accounts to an out-of-state GA may result in the loss of these important tools and therefore result in lower recoveries.

A13: Brian Siegel – We have not yet determined whether it will be necessary for legal title of defaulted loans to be transferred to the guaranty agency responsible for Guaranty Agency Responsibility Area I (Claims and Collections). If a Team proposal involves a state in which the current guaranty agency has expanded legal tools to recover defaulted loans and has been effective in using those tools, we would be interested in developing a VFA that does not involve requiring the transfer of legal title to the loans. [Posted June 27, 2011]

Q14: What are ED's plans for ensuring that GA's transitioning into a VFA experience no interruption in cash flows during the switch in funding models?

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A14: Jay Hurt - We understand the importance of cash flow to the GAs and we will make sure there is no interruption in those cash flows. [Posted June 27, 2011]

Q15: It has been reported that GAs can propose to perform services for Direct Lending under a VFA. Is this correct?

A15: Brian Siegel- A VFA has to focus on the FFEL Program. Two of the four GA Responsibility Areas – Areas 1 (Claims and Collections) and IV (Lender Oversight) are strictly FFEL related. It is possible that guaranty agencies providing services in GA Responsibility Areas II (Default Aversion) and GA Responsibility Area III (Outreach, Training, and School Oversight) may provide services that relate to or discuss Direct Loans but those services will not be services provided to the Direct Loan Program directly. [Posted June 27, 2011]

Q16: What is contemplated if new VFA agreements are cancelled by the Secretary?

A16: Jeff Baker - While the Secretary does have the authority to terminate a VFA, especially because of cost neutrality, we don't expect that to happen. We understand that operating under a VFA will be a major shift of the agencies in terms of infrastructure and activities. We expect that if we are all careful and do a good job over the next few months and get these VFAs developed properly, there should not be a problem with them being terminated precipitously, unless there is a complete failure of the VFA and we're certainly not expecting that. We do understand that there is significant transition cost implications and infrastructure as you move to a new model. [Posted June 27, 2011]

Q17: If a GA proposal is not accepted, does the GA continue to operate under the regular GA agreements, or do the activities of the GA get assigned by the Department to other agencies operating an approved VFA?

A17: Jeff Baker - GAs that either chose not to submit a proposal or otherwise do not enter into a VFA will continue to operate under the regular agreement that they now have with the Secretary. We are very concerned about the viability of the guaranty agencies, about the protection of the Federal assets, and about the need to have these other activities performed well. Therefore, our oversight will be focused to ensure that we have viability throughout the system, both for GAs that are in a VFA and those that are not. [Posted June 27, 2011]

Q18: Will an agency be given an opportunity to modify its VFA to alter partnership arrangements if a partner's VFA agreement with the Secretary is terminated or if it fails to perform up to the agency's standards? Will an agency be permitted to add partners to its VFA agreement after the agreement's start date?

A18: Jeff Baker - Obviously in a team approach if one of the agencies within a team leaves the VFA we'll have to do some adjusting. We'll work with the other agencies in that team to ensure all of the activities are covered. It may be possible that the agencies in the existing team can pick up all or some of the responsibilities of the agency that left, or we may have to redistribute those activities to other GAs that are operating under a VFA. But, an agency that is outside of the VFA process will not be part of this unless we made a decision to open up the process again. That is why it is important that we get serious VFA proposals, and that both the Department and the agencies act in good faith to get these VFAs established because an agency not participating in a VFA will be not be able to come in later to fill a gap. [Posted June 27, 2011]

Q19: Can a VFA be renegotiated in the future based on changing needs assessments of students and schools, and market conditions?

A19: Jeff Baker - As noted, we'll look at the VFAs at least on an annual basis certainly for the cost neutrality. The world is changing in higher education financially and otherwise, so it is possible that we will need to have conversations with VFA agencies to see if it would be appropriate to make adjustments to the VFA. [Posted June 27, 2011]

Q20: If a guaranty agency submits a solo proposal to provide two or three Responsibility Area activities, must the agency identify another GA to perform the remaining Responsibility Area activities or will the Department identify another agency to provide those services under a separately approved VFA?

A20: Jeff Baker - Obviously all of the activities have to get covered and since no one agency under this VFA proposal can do all four GA Responsibility Areas, we would have to find another agency to pick up the two or three that the agency chose not to propose. But that is something we will do cooperatively. It is a bit of "matchmaking" and one that is very cooperative. We're going to make sure there are good relationships between and among the agencies so the VFAs are effective. [Posted June 27, 2011]

Q21: How many agencies is the Department expecting will perform each of the responsibility areas?

A21: Jeff Baker - We believe in this VFA approach in spite of the decreasing revenues, because we can find savings in the economies of scale that come with having far fewer agencies doing GA Responsibility Area I (Claims and Collections). As we noted very clearly in the notice, we're looking for those agencies to step-up and to prove to us that they have the capabilities and demonstrated competencies to perform those functions on a broader scale and at reduced costs. In terms of the other service areas the number of GAs participating will be whatever it takes to cover the nation, whatever it takes to keep as many GAs viable and operating and servicing areas they traditionally served. There are no quotas or limits on those other areas. We want to wait and see the proposals. [Posted June 27, 2011]

Q22: By entering into a teaming VFA, will the portfolios of the team members be interchangeable? Will loans outside of the team members' portfolios be added to their portfolios?

A22: Jeff Baker - We're waiting for the proposals to see how to handle the portfolios in the case of GA Responsibility Area I (Claims and Collections) and to a lesser extent for GA Responsibility Area II (Default Aversion). There obviously will have to be sharing of data for these two GA Responsibility Areas and a little less so for the other two GA Responsibility Areas. Therefore, we have not determined and purposely did not determine in the notice, what the best approach will be. It could be just a servicing issue with legal title remaining with an agency. As mentioned, a portfolio outside of the VFA family, not the team, but the whole VFA family will not be moved. [Posted June 27, 2011]

Q23: Will access to federal data (e.g. National Directory of New Hires (NDNH), IRS income retrieval, NSLDS, etc.) be made available to VFA guarantors to assist in performance of the various responsibility areas?

A23: Jeff Baker - Certainly access that you have now, and we understand there are some challenges there and we're working very hard to resolve them, will be made available to all guaranty agencies whether they are in a VFA or not. We know that this is a gap that we have to resolve. We do want to acknowledge and point out one of the major reasons we're having problems with our friends at HHS and the IRS is because of security and privacy issues (FISMA). [Posted June 27, 2011]

Q24: How is the term “service area” defined/understood?

A24: Jeff Baker - Depending upon the responsibility area, like GA Responsibility Area I (Claims and Collections), it's about the portfolios of defaulted loans and collecting on them whether legal title is exchanged or not. It is about the portfolio of loan guarantees that are out with our FFEL lenders and who is responsible for reviewing and paying those claims. It is about loan portfolios in terms of GA Responsibility Area IV (Lender Oversight) because that oversight would be related to those lenders who hold those loans that are guaranteed. In terms of the two other GA Responsibility Areas of default aversion and school oversight and school training, it is probably geographic areas or areas where there is currently a presence of the guaranty agency. [Posted June 27, 2011]

Q25: Do guaranty agencies need to be FISMA compliant?

A25: Jim Runcie - Yes. It is essential that the guaranty agencies protect the integrity of the data of students who received loans under the FFEL Program, and any other personally identifiable information (PII) held by the agency. All agencies must indicate how they will address FISMA compliance. That is not just for VFAs, but for all guarantors. [Posted June 27, 2011]

Q26: What will the Department do if an agency submits more than one proposal?

A26: Jim Runcie - That is something that we specifically allowed for in the Federal Register notice. Each proposal will be evaluated and, if appropriate, some of the ideas from multiple proposals could be combined. [Posted June 27, 2011]

Q27: Can one GA be included in more than one team proposal? Can a GA enter into a VFA that allows it to be a participant on more than one team?

A27: David Bergeron - A GA can be included in more than one team proposal. We specifically invited GAs to consider participating in more than one team. Ultimately, it will result in a single VFA with each GA and that VFA could include the participation of the GA in multiple teams. [Posted June 27, 2011]

Q28: If a GA submits a proposal, is it required to negotiate and enter into a VFA that reflects that proposal?

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A28: David - No, but as noted we expect proposals to be submitted in good faith with an intent to work with the Department to develop an agreed upon VFA that is generally reflective of the proposal that was submitted. That said, the submission of the proposal does not commit the Guaranty Agency to enter into a VFA arrangement at the end of the process. [Posted June 27, 2011]

Q29: If a GA submits multiple proposals, must it agree to perform under the one chosen by ED?

A29: David Bergeron - This is going to be a process of negotiation that begins with the submission of proposals by August 1. [Posted June 27, 2011]

Q30: What do you mean by saying the emphasis is on outcomes?

A30: Jeff Baker - What we said throughout the notice, both in the general discussion and in the discussion of each of the GA Responsibility Areas, is that we are much less interested in output than outcomes. We are not interested in counting visits or counting brochures distributed. For example in GA Responsibility Area II (Default Aversion) we provide an example that an outcome measure of the effectiveness of student loan counseling might be by looking at whether the students have an understanding of what it means to finance their education through borrowing. That would be opposed to an agency submitting data that they did this much counseling and had this many visits.

In GA Responsibility Area III (Outreach and School Training and Oversight) we are less interested in learning that an agency conducted X number of oversight visits than whether it can demonstrate that those schools that were visited are in compliance or based upon the intervention of the GA that there was some mitigation of a compliance problem. We think there are plenty of opportunities to show in the evaluation that there are outcomes and not just counting of things. [Posted June 27, 2011]

Q31: Is there any benefit to offering a team proposal vs. an individual proposal?

A31: Jeff Baker- Because no one agency can participate in all four of the GA Responsibility Areas, there has to be partners. If an agency comes in on a team proposal, or multiple team proposals, that make sure all activities get taken care of that would be great. If an agency wants to come in and do just one or two of the activities the other activities have to be transitioned to another agency or team. We're waiting to see what we get from the agency proposals to see how much matchmaking we have to do.

We do want to emphasize, just for the record, that while we certainly will give a lot of credence to your proposals and who you think the other agencies should be and how that should work, we are not making any commitment at this point that the team will stand as you submitted. We're hopeful we won't have to switch anything around except to add to an agency's or to a team's activities because there is a gap somewhere. [Posted June 27, 2011]

Q32: Will there be other changes or requirements imposed on guaranty agencies that do not enter into a VFA and continue to operate under the regular guaranty agency agreements.

A32: Jim Runcie - We will continue, and probably increase, our oversight because of previously stated concerns about the lack of continued viability under the current business model and the need to ensure that all important activities are performed well. We started some of this oversight already with on-site security reviews. We expect we will have more of those. In the near future we will continue our due diligence sessions. We started those about a year and a half ago when we went through a formal due diligence process. We want to ensure the viability of the GAs, both those within the VFA construct and those outside so we can manage our risk accordingly. [Posted June 27, 2011]

Q33: Is it possible for a guarantor to submit a proposal involving another guarantor without that guarantor necessarily wanting to participate?

A33: Jim Runcie - No, what we are looking for is a team approach where folks have decided how they are going to work together and how they are going to put a collective financing model in place. While there may be instances where after we receive a proposal we might offer alternative solutions that might invite additional partnering, it needs to be a collaborative approach. From an operational standpoint each GA included in a joint proposal, must sign the proposal. [Posted June 27, 2011]

Q34: If a guaranty agency submits a proposal by August 1, what is the expected timeline for the Department to respond to individual guarantors and to start a process of negotiation?

A34: Jeff Baker - We have not laid out a specific timeline because we don't know how many proposals will be submitted and how complex they will be. That said, we are committed to moving the process along expeditiously, although carefully. We don't expect this to be month-to-month-to-month. Once we get to August 1, we will perform a preliminary review of the proposals received and, if necessary, reach out to agencies to get clarification. We expect this to be over the first couple of weeks in August. Then we will enter into serious discussions with GAs in early fall. We think that once we get past Aug 1, we'll be able to get a schedule out that is a little more precise. [Posted June 27, 2011]

Q35: You made clear that August 1, is a firm deadline for submitting a VFA proposal. Is it possible for a GA that submits a VFA proposal by the August 1st deadline to then submit a totally different VFA proposal?

A35: Jim Runcie - We are expecting serious, well thought out, and comprehensive proposals. We know sometimes there may be some conditional constraints that you have to highlight, but we're not expecting there would be a wholesale change in a proposal. You can submit multiple proposals by August 1, and as we work through them some of the details might change. [Posted June 27, 2011]

Jeff Baker – One of the reasons for this and the same reason why we are having this call and inviting all of you, is that it's all about being transparent and equitable. While this is not a competition, if we allow an agency to come in with a different proposal, we've basically waived the August 1, deadline for that agency and that's just not right. The changes that we might consider, given that you only have 60 days and now it's down to about 45 or 40 days – is getting commitments from other agencies. So, if the structure is pretty much the same, but you've had some conversations and want to suggest a new team member, we will consider such a change. [Posted June 27, 2011]

Q36: I understand your note about increased oversight and so forth, continuing due diligence, managing risk and so forth as it relates to non-VFA agencies. One of the specific things the group is interested in knowing about is in the VFA both the Federal Fund and the Operating Fund could be treated as you (GA) propose. If you did not submit a VFA, our assumption is that the agency's Operating Fund would remain as is, unless the Department determines that there is some sort of significant risk. Is that a correct assumption?

A36: Jim Runcie - If an agency does not participate under a VFA, the Federal Fund and Operating Fund dynamics would remain as is. The agency would be operating under the statutory guidance that is out there for guaranty agencies. Now, if we determine that there is financial risk, operational risk, security risk, or other risk, that we may need to address, then there may be some further discussion that we would follow. [Posted June 27, 2011]

Jay Hurt – We would expect the VFA proposed business models will result in longer term viability for the agency(s). Obviously we will be closely watching those agencies that don't participate under a VFA and if we start seeing issues with the Federal Fund and we need to step in, we will. Again, we're looking for proposals with a little more long-term viability under the VFAs. [Posted June 27, 2011]

Q37: If cost neutrality is tied to a FFEL portfolio that is declining, does the revenue available for the VFAs decline with the portfolio in the next years as the portfolio amortizes?

A37: William Graham - As the FFEL Program matures and loans are paid off there will be less revenue going into the system. That's inevitable. Whether or not that tracks exactly to reduced revenues going to an agency or team of agencies operating under a specific set of VFAs depends on a number of factors, some of which the VFAs are intended to address. What we are trying to find are longer term business relationships that can work with a declining FFEL portfolio. [Posted June 27, 2011]

Q38: Can demonstrated savings in the Direct Loan Program be used to meet the overall VFA cost neutrality requirements?

A38: William Graham – No, because VFAs are funded under Part B which are FFEL appropriations. You can't take savings from Part D (Direct Loans) and apply those to Part B. [Posted June 27, 2011]

- Q39: It seems as if the state agencies typically are going to have collection tools that would result in better Direct Loan collection outcomes. I understand the issue of the statute, but it seems that might be the most efficient way to fund Direct Loans services for GA Responsibility Areas II (Default Aversion) and GA Responsibility Area III (Outreach, School Support, and School Oversight).
- A39: Jeff Baker - State agencies have authority for state tax offset and similar collection tools because it is a state agency with a state responsibility to collect. Direct Loans are a federal responsibility to collect, so we are not sure a state agency would be able to use those tools for Direct Loans. More importantly we have contracts for collections with our servicers, and we'll have more of them when we move to the not-for-profit servicers. [Posted June 27, 2011]
- Q40: How would agencies go about collecting on other Guaranty Agency paper? Would that not be considered 3rd party collections?
- A40: Jim Runcie – It really depends on how the proposal is structured more than anything else. If the defaulted loan portfolio is transferred that wouldn't be an issue. There could be some models that involve joint servicing. There could be models that involve the actual transitioning of the defaulted loan portfolio. There could be a number of different constructs. [Posted June 27, 2011]