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Information Item

California Student Aid Commission

Update on the Voluntary Flexible Agreement

The Voluntary Flexible Agreement (VFA) between the Commission and the U.S. Department of Education (USDE) remains outstanding. The USDE has informed Commission staff that the VFA is not likely to move forward until some outstanding issues about the administration of the Federal Family Education Loan Program in California, and more specifically the working relationship among CSAC, EdFund and the Department of Finance, are satisfactorily resolved.

On October 3, 2008, EdFund President Sam Kipp emailed CSAC Executive Director Diana Fuentes-Michel with his concerns about the VFA. (See Tab 7.a) Executive Drector Fuentes-Michel's response to his concerns may be found at Tab 7.b.

On October 7, 2008, Executive Director Fuentes-Michel requested the assistance of the Director of Finance in resolving USDE's concerns, and potentially meeting with USDE, so that the VFA could be implemented. (See Tab 7.c) The Director of Finance has not responded to this request.

Responsible Persons: Keri Tippins
General Counsel

Ed Emerson, Chief
Federal Policy & Programs Division

From: Sam Kipp
To: Diana Fuentes-Michel
CC: Fred.Klass@dof.ca.gov; Jeannie.Oropeza@dof.ca.gov;

Date: 10/3/2008 8:12 AM
Subject: VFA and Other Concerns

Diana,

I am writing you because of my concern over two issues: (1) the status of the VFA and (2) a recent conversation with a senior staff member at the U.S. Department of Education that intimated CSAC had requested that the Department not communicate directly with EdFund.
Wednesday marked a full two months past the date that the Department was willing to enter into a new VFA with CSAC based upon the Department's edits to the draft VFA agreement that you authorized EdFund to negotiate The Early Withdrawal Counseling Unit is operating, the counselors are actively assisting the more than 60,000 at risk borrowers they expect to help each year, and yet the delay in the Commission implementing the new agreement has cost the Operating Fund an estimated $1.5 million so far -- an amount that increases with each passing day.

I recently had a conversation with the CEOs of two other former VFA guarantors about the status of their negotiations with the Department. One expects to have a completed and signed agreement within a month and both are very concerned about completing all negotiations before any additional senior administration officials leave the Department. Yet when I tried to inquire of the Department about the status of the Commission's VFA agreement, it was intimated that CSAC had requested they not speak directly with anyone at EdFund on this or other issues.

This development, if true, will produce major obstacles for us that will not serve the best interests of the Commission, EdFund, the State of California, and the students and institutions who depend on us for essential loan program services. This is not a question of who is California's designated guarantor or about the Commission's exercise of its oversight responsibilities; it is a fundamental question of whether or not EdFund will continue to have the direct contact with U.S. Department of Education officials that has always been essential to meet our responsibilities to implement new loan program initiatives and requirements (VFA, LLR, PL 110-227, etc.), and properly administer the essential guarantee services that we are expected to provide to the Commission, students and institutions in the federal loan program.

Throughout its history, the Commission's loan program interests have been best served by direct communication between EdFund and the Department of Education. The timeliness, accuracy, and effectiveness in meeting our FFEL legal and administrative responsibilities, exceeding students' expectations, and protecting the interests of the state require such direct communications. If indeed, you have asked the Department not to communicate directly with EdFund, I would request that you reconsider that action. I would also appreciate an update on the status of discussions with the Department on the new VFA.

Thank you for your consideration and assistance.

Sincerely,

Sam Kipp

CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR

CALIFORNIA STUDENT AID COMMISSION 1955—2005 YEARS SERVING STUDENTS

MEMORANDUM

DATE: OCTOBER 3, 2008

TO: SAM KIPP, III
EDFUND PRESIDENT

FROM: DIANA FUENTES-MICHEL
EXECUTIVE DIRECTOR

Diana Fuentes-Michel

SUBJECT: OCTOBER 3, 2008 EMAIL CONCERNING VOLUNTARY FLEXIBLE AGREEMENT (VFA) AND U.S. DEPARTMENT OF EDUCATION (USDE)

Sam,

In your email dated October 3, 2008, you have stated two concerns. First, you have expressed concerns about the Voluntary Flexible Agreement (VFA). Second, you have characterized a conversation you have had with a senior staff member of the United States Department of Education (USDE) as intimating that the Commission has asked USDE not to communicate directly with EdFund.

With respect to the first issue, the status of the VFA, USDE has informed the Commission staff that there is not likely to be a VFA until USDE has resolved several areas of concern. Specifically, USDE has informed us that the current working relationship between the Commission and EdFund, along with the overlay of the authority given to the Director of Finance, has raised programmatic concerns about how the Federal Family Education Loan (FFEL) Program is being administered in California. USDE has also indicated that it is reviewing the issue of whether EdFund implemented default fee strategies inconsistent with federal law and regulations. Commission staff was informed that execution of the VFA will require some additional time until USDE can satisfactorily resolve these issues,

It is unclear from your email whether your second concern relates to the VFA or some other issue. With respect to the VFA, as you will recall, a past Commission had directed me to delegate responsibility to you to negotiate a VFA with USDE, and authorized me to sign a resulting VFA if it was substantially similar to a proposal you had shown to the Commission. You submitted that proposal to USDE, but USDE responded with its own proposed VFA. According to David Reid, you forwarded USDE's proposed VFA to the Commission without further negotiations with USDE and recommended the Commission sign USDE's proposed VFA.

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The Commission, from that time forward, took responsibility for finalizing the VFA with USDE. The former Commission Chair, Peter Hankwitz, informed you by letter dated July 29, 2008 that all further negotiation of the VFA would be handled by the Commission's General Counsel since the outstanding issues on the terms of the VFA are related to the Commission's responsibility and liability under the VFA. The Commission's General Counsel concluded, however, that USDE's proposal differed substantially from the proposal you had shown the Commission. In particular, USDE's proposed VFA was explicit in making the Commission liable for EdFund's actions under the VFA, and also expressly provided that USDE could terminate the VFA upon any change in the executive management, i.e., the Executive Director and senior management of the Commission.

The Commission staff asked USDE whether the proposed VFA was non-negotiable or whether further negotiations could take place. USDE indicated that the terms of the program component – EdFund's proposed Early Withdrawal Counseling – were not open to negotiation, but that other terms were. Thus, any operational or implementation concerns you may have should be allayed.

The Commission staff proposed to USDE that the express liability of the Commission for EdFund's actions be changed by substituting the State of California or the Department of Finance for the Commission, on the grounds the Director of Finance's ultimate authority under SB 89 over matters affecting the sale of the state's student loan guarantee program assets, including his authority and responsibility to approve or disapprove all Commission actions before those actions become effective, transferred ultimate responsibility for the operations of the student loan guarantee program from the Commission to the Director of Finance.

USDE rejected the Commission staff's proposal on the grounds that the Commission, not the Director of Finance, is the designated student loan guarantee agency for California and is the entity that signed the agreement with USDE to administer the Federal Family Education Loan Program in California. A USDE representative further indicated to the General Counsel that USDE viewed EdFund as no more than a vendor, and that USDE's relationship was with the Commission.

The Commission staff also proposed that the provision that USDE could terminate the VFA upon any change in the Commission's executive management be eliminated from the proposed VFA. The USDE representative indicated that the USDE program division responsible for oversight of the administration of the FFEL Program in the states requested that this particular provision be added to the USDE. Commission staff did not consider such a provision appropriate for a State agreement, as it would have made $8-9 million in revenue to the State for each year of the VFA dependent on the continued employment of the Executive Director and the Commission's senior management staff. While you did not have any concerns about this provision, since you recommended the Commission sign USDE's proposed VFA that included that provision, Commission staff believed that the provision was not acceptable from a public policy perspective, and was not consistent with the State's interests,.

As noted above, former Commission Chair Peter Hankwitz informed you by letter dated July 29, 2008 that all further negotiation of the VFA would be handled by the Commission's General Counsel since the outstanding issues on the terms of the VFA are related to the Commission's responsibility and liability under the VFA. This has been communicated to USDE. The Commission's General Counsel continues to work with USDE to resolve the technical language issues of the VFA itself. As also noted above, however, the VFA is not likely to be executed until the larger issues between the Commission, EdFund and the Director of Finance are resolved.

To the extent that your second concern does not involve the VFA, I am not able to respond to your concerns because I do not understand what you mean by "intimated." It appears that USDE did not expressly say that the Commission staff asked USDE not to communicate directly with EdFund, bur rather, that you are interpreting some words used by USDE, and perhaps a refusal by USDE to discuss the VFA with you, to conclude that the Commission staff made such request to USDE.

If, in fact, USDE refused to talk to you about the VFA, USDE's refusal would be consistent with the direction of the Commission chair in delegating further negotiation of the VFA to the Commission's General Counsel. Alternatively, their refusal would also be consistent with their statements to us that USDE's relationship is with the Commission, as the designated student loan guarantee agency, and that EdFund is merely a vendor.

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CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR

October 7, 2008

Mr. Michael Genest
Director
Department of Finance
915 L Street
Sacramento, CA 95814

Dear Director Genest:

This letter is intended to provide you with an update on the Voluntary Flexible Agreement (VFA) that the California Student Aid Commission (Commission) is seeking to finalize with the United States Department of Education (USDE), and to seek your cooperation with the Commission to resolve issues of concern to the USDE that are delaying USDE's approval of the VFA.

As you may be aware, the United States Department of Education entered into an agreement with the Commission in which the Commission is designated as the student loan guarantee agency for California under the provisions of the Federal Family Education Loan Program (FFEL Program). The FFEL Program allows USDE to enter into VFAs to enhance program integrity, increase cost efficiencies, and allow flexibility to experiment and improve delinquency and default prevention. The Commission was one of five student loan guarantee agencies with an approved VFA.

> Voluntary Flexible Agreements must be "cost neutral." According to USDE, reductions in the financing model for student loan guarantee agencies enacted as part of the federal College Cost Reduction Act (effective October 1, 2007) meant that existing VFAs were no longer cost neutral. On October 2, 2007, USDE announced that the current VFA contract between the Commission and USDE would be terminated on December 31, 2007. Legislative language included in the Omnibus Appropriation Bill directed the U.S. Secretary of Education to renegotiate VFAs with the guarantee agencies. In April 2008, based upon a previous Commission direction, the Executive Director of the Commission provided USDE with a letter indicating that the President of EdFund, the Commission's auxiliary organization, would be acting as liaison on behalf of the Commission regarding VFA and implementation plans, specifically noting that all VFA correspondence would continue to be routed through the Executive Director.

The Commission had directed the Executive Director to delegate responsibility to the EdFund President to negotiate a VFA with USDE, and authorized the Executive Director to sign a resulting VFA if it was substantially similar to a proposal that EdFund had shown to the Commission. EdFund submitted that proposal to USDE, but USDE responded with its own proposed VFA. According to EdFund's General Counsel, the EdFund President forwarded USDE's proposed VFA to the Commission without further

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negotiations with USDE and recommended the Commission sign USDE's proposed VFA.

The Commission, from that time forward, took responsibility for finalizing the VFA with USDE. The former Commission Chair informed the EdFund President by letter dated July 29, 2008 that all further negotiation of the VFA would be handled by the Commission's General Counsel since the outstanding issues on the terms of the VFA are related to the Commission's responsibility and liability under the VFA. The Commission's General Counsel concluded that USDE's proposal differed substantially from the proposal EdFund had shown the Commission. In particular, USDE's proposed VFA was explicit in making the Commission liable for EdFund's actions under the VFA, and also expressly provided that USDE could terminate the VFA upon any change in the executive management, i.e., the Executive Director and senior management of the Commission.

The Commission staff asked USDE whether the proposed VFA was non-negotiable or whether further negotiations could take place. USDE indicated that the terms of the program component – EdFund's proposed Early Withdrawal Counseling – were not open to negotiation, but that other terms were.

The Commission staff proposed to USDE that the express liability of the Commission for EdFund's actions be changed by substituting the State of California or the Department of Finance for the Commission, on the grounds the Director of Finance's ultimate authority under SB 89 over matters affecting the sale of the state's student loan guarantee program assets, including his authority and responsibility to approve or disapprove all Commission actions before those actions become effective, transferred ultimate responsibility for the operations of the student loan guarantee program from the Commission to the Director of Finance.

USDE rejected the Commission staff's proposal on the grounds that the Commission, not the Director of Finance, is the designated student loan guarantee agency for California and is the entity that responsible under the signed the agreement with USDE to administer the Federal Family Education Loan Program in California. A USDE representative further indicated to the General Counsel that USDE viewed EdFund as no more than a vendor, and that USDE's relationship was with the Commission.

The Commission staff also proposed that the provision stating that USDE could terminate the VFA upon any change in the Commission's executive management be eliminated from the proposed VFA. The USDE representative indicated that the USDE program division responsible for oversight of the administration of the FFEL Program in the states requested that this particular provision be added to the VFA. Commission staff did not consider such a provision appropriate for a State agreement, as it would have made $8-9 million in revenue to the State for each year of the VFA dependent on the continued employment of the Executive Director and the Commission's senior management staff. While EdFund did not appear to have any concerns about this provision, Commission staff believed that the provision was not acceptable from a public policy perspective, and was not consistent with the State's interests.

The United States Department of Education has recently informed the Commission staff that there is not likely to be a VFA until USDE has resolved several areas of concern. Specifically, USDE has informed Commission staff that the current working relationship between the Commission and EdFund, along with the overlay of the authority given to the Director of Finance, has raised programmatic concerns about how the FFEL Program is being administered in California.

USDE has also indicated that it is reviewing the issue of whether EdFund implemented default fee strategies inconsistent with federal law and regulations. Commission staff was informed that execution of the VFA will require some additional time until USDE can satisfactorily resolve these issues.

The Commission's General Counsel continues to work with USDE to resolve the technical language issues of the VFA itself. As also noted above, however, the VFA is not likely to be executed until USDE reaches resolution of the larger issues among the Commission, EdFund and the Director of Finance.

To this end, the Commission would request your cooperation in resolving those USDE issues so that the VFA for California can be signed and implemented. USDE representatives have indicated that they may be available to meet with representatives of the Commission, the Department of Finance and EdFund as a first step in that process.

I am available at 916-464-8271 to work with your representative to arrange a meeting with USDE, and to answer any questions you may have on the VFA or any other matter relating to the FFEL Program.

Sincerely,

Diana Fuentes-Michel

Diana Fuentes-Michel
Executive Director

CC: Members of the California Student Aid Commission
Mr. Fred Klass, Chief Operating Officer, Department of Finance
Ms. Jeannie Oropeza, Program Budget Manager, Department of Finance
Dr. Sam Kipp, III, President, EdFund