COMMITTEE ON ECONOMIC AND EDUCATIONAL OPPORTUNITIES

U.S. HOUSE OF REPRESENTATIVES
2181 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6100

May 3, 1995

Ms. Darcy E :adbury
Deputy Assi :tant Secretary of the
Treasury !or Federal Finance
US Departme :t of the Treasury
1500 Pennsy .vania Avenue, NW
Washington, DC 20220

Dear Ms. Br dbury:

I grea ly enjoyed your testimony today before my subcommitte . I think those Members in attendance received some very valuab e information. I also appreciate your willingness to review the raft proposal we have been working on with Sallie Mae with respec to privatization. I recognize your expertise in this area a d your timely assistance is greatly appreciated.

Enclos d is a copy of the proposal we have had under review. Privatizati n legislation is on a fast track due to the extensive legislative schedule we have planned for the next three months. If you coul provide any suggestions or changes to the enclosed proposal in the next day or two, I would be very grateful. Our Committee s aff is available to meet with you to review the draft at your con enience.

Please let me know if you have any problem with this request. Th committee staff working on this proposal are George Conant and S lly Stroup. They can be reached at 225-6558.

Again, hank you for your testimony this morning and your assistance i reviewing the enclosed proposal.

Sincerely,

Howard P. "Buck" McKeon

Howard P. "Buck" McKeon, Chairman
Subcommittee on Postsecondary
Education, Training and
Life-Long Learning

DETERMINED TO BE AN ADMINISTRATIVE MARKING
INITIALS: RLCR DATE: 03/09/12
2011-0265-S

ATTORNEY WORK PRODUCT
PRIVILEGED AND CONFIDENTIAL

104th CONGRESS
1st Session **H.R.________**

To amend Part B of Title IV of the Higher Education Act of 1965 to provide for the reorganization of the Student Loan Marketing Association.

IN THE HOUSE OF REPRESENTATIVES
[ ], 1995

Mr(s) introduced the following bill; which was referred to the Committee on

---

A BILL

To amend Part B of Title IV of the Higher Education Act of 1965 to provide for the reorganization of the Student Loan Marketing Association.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as "The Student Loan Marketing Association Transition Act of 1995".

SEC. 2. FINDINGS AND PURPOSES:

(a) FINDINGS -- The Congress hereby finds that:

(1) The Student Loan Marketing Association, since its creation by Congress in 1972, has successfully developed a national secondary market in guaranteed student loans, providing stability and liquidity to the market for student

DRAFT
April 2?, 1995

loans ar i facilitating access to loans for all eligible borrowe: ɜ.

SM draft

(2) There is not a continuing need to maintain the Ass(:iation as a federally chartered government-spon-sored e: terprise on a long term basis because the student loan se(ondary market has ~~become~~ a competitive environment, particu: arly in light of the federal government's program of direct : ending to students which was enacted in 1993 and is project: d to encompass up to 60% of aggregate student loan volumes by 1998.

(3) It is in the interest of taxpayers to limit any imp icit government guarantee that government-sponsored enterpr se liabilities may carry.

(4) It is desirable (A) to maintain the Asso-ciation as a government-sponsored enterprise on a short-term transit onal basis and (B) to ensure an orderly wind down of the Ass ciation's charter that preserves the reasonable expecta ions of the Association's investors, creditors, cus-tomers nd other business relations.

(b PURPOSES -- The purposes of this Act are to permit the gra lual transfer of the Association's business, opera-tions a id assets to a new State or District of Columbia-charter id parent holding company and the termination of the Associa :ion's federal charter on or before December 31, 2004, a id to preserve the federal agency status of the Associa :ion's debt obligations for so long as they remain outstar ling.

SE :. 3. THE STUDENT LOAN MARKETING ASSOCIATION TRANSITION, DISSOLUTION AND CHARTER TERMINATION.

(a) Part B of Title IV of the Higher Education Act of 196! [20 U.S.C. §1071 et seq. (1988)] is amended by insert: ıg after section 439 [20 U.S.C. § 1087-2] the fol-lowing ıew section:

"- REORGANIZATION OF THE STUDENT LOAN MARKETING ASSOCIATION THROUGH THE FORMATION OF A HOLDING COMPANY.

"Sec. 40 (a) Actions by the Association's Board of Direc-tors - The Board of Directors of the Association shall take or cause to be taken all such action as it deems necessary or appropriate to effect, upon the shareholder approval described below, a restructuring of the common stock ownership of the Association, as set forth in a plan of reorganization adopted by the Board of Directors (the terms of which shall be consistent with this Act) so that all of the outstanding common shares shall be directly owned by an ordinary business corporation chartered under State or District of Columbia law (the "Holding Company"), as the Board of Directors may determine. Such actions may include, in the Board's discretion, a merger of a wholly-owned subsidiary of the Holding Company with and into the Association, which would have the effect provided in the plan of reorganization and the law of the jurisdiction in which such subsidiary is incorporated. As part of the restructuring, the Board of Directors may cause (1) the common shares of the Association to be converted, at the Effective Time, to common shares of the Holding Company on a one for one basis, consistent with applicable State or District of Columbia law, and (2) Holding Company common shares to be registered with the Securities and Exchange Commission.

"(b) Shareholder Approval - The plan of reorganization adopted by the Board of Directors pursuant to subsection (a) shall be submitted to common stockholders of the Association for their approval. The Reorganization shall occur at the Effective Time, provided that the plan of reorganization has been approved by the affirmative votes, cast in person or by proxy, of the holders of a majority of the issued and outstanding shares of the Association common stock.

"(c) Transition - Except as specifically provided in this Section 440, until the Dissolution Date the Association shall continue to have all of the rights, privileges and obligations set forth in, and shall be subject to all of the limitations and restrictions of, section 439 of the Higher Education Act [20 U.S.C. § 1087-2] as in effect on the effective date of this Act. The Holding Company and its affiliates other than the Association shall not be entitled to any of the rights, privileges and obligations, and shall not be subject to the limitations and restrictions, applicable to the Association under section 439 of the Higher Education Act [20 U.S.C. § 1087-2] as in effect on the effective date of this Act, except as specifically provided in this Section 440.

new

"(1) **Transfer of Certain Property** - Except as specifically provided herein, at the Effective Time or as soon as practicable thereafter, the Association shall use its best efforts to transfer to the Holding Company and/or its Subsidiaries, in each case, as directed by the Holding Company, all real and personal property of the Association (both tangible and intangible) other than the Remaining Property. Without limiting the foregoing, such transferred property shall include all right, title and interest in (i) direct or indirect subsidiaries of the Association (excluding any interest in any government sponsored enterprise), (ii) contracts, leases, and other agreements, (iii) licenses and other intellectual property, and (iv) any other property of the Association. Notwithstanding the foregoing, nothing contained herein shall be construed to prohibit the Association from transferring Remaining Property from time to time to the Holding Company or its Subsidiaries, subject to the provisions of subsection (3) below.

"(2) **Transfer of Personnel** - At the Effective Time, employees of the Association shall become employees of the Holding Company (or of the Subsidiaries), and the Holding Company (and/or the Subsidiaries) shall provide all necessary and appropriate management and operational (including loan servicing) support to the Association, as requested by the Association. The Association may, however, obtain such management and operational support from other persons or entities.

"(3) **Dividends** - The Association may pay dividends in the form of cash or noncash distributions so long as at the time of the declaration of such dividends, after giving effect to the payment of such dividends as of the date of such declaration by the Board of Directors of the Association, the Association's capital would be in compliance with the capital standards set forth in section 439(r) [20 U.S.C. § 1087-2].

"(4) **Valuation of Non-Cash Distributions** - After the Effective Time, any distribution of non-cash assets by the Association to the Holding Company shall be valued at book value on the date the Association's Board of Directors approved such distribution for purposes of calculating compliance with section 439(r) [20 U.S.C. § 1087-2(r)].

"(5) **Restrictions on New Business Activity or Acqu sition of Assets by Association** - After the Effective Ti e, the Association shall not engage in any new business ac ivities or acquire any additional assets other than (i) pri r to the last day of the thirty-sixth full calendar month i mediately following the Effective Time in connection with co tractual commitments for future student loan purchases r warehousing advances or pursuant to letters of credit r standby bond purchase agreements, in either case which a e outstanding as of the Effective Time and (ii) in connect on with its serving as a lender-of-last-resort pursuan to section 439 of Part B of Title IV of the Higher Educati n Act [20 U.S.C. § 1071 *et seq*.].

"(6) **Restrictions on Additional Indebtedness of the ssociation; Attributes of Debt Obligations** - After the Eff ctive Time, the Association ~~shall not incur~~ indebtedness hich at any given time ~~would exceed~~ the aggregate book va ue of its assets, to the extent such assets are permitt d to be held under this subsection. The Association shall n t issue new debt obligations after the last day of ~~the thi ty-sixth full calendar month immediately following the Eff ctive Time~~, except in connection with its serving as a lende -of-last-resort pursuant to section 439 of Part B of Title I / of the Higher Education Act [20 U.S.C. § 1071 *et seq*.]. Notwithstanding the foregoing, nothing in this subsectior 440(c) shall in any way whatsoever modify the attribute accorded the debt obligations of the Association by sectior 439 of Part B of Title IV of the Higher Education Act [2(U.S.C. § 1087-2], regardless of whether such debt obligat ons are incurred (i) prior to the Effective Time, (ii) af er the Effective Time and prior to the last day of the thi ty-sixth month period described above, or (iii) after a y such obligations are transferred to a trust in accord ce with subsection 440(d).

"(7) **Tax Matters** -

(1) **Interest deduction** - The following obligations nall not constitute tax-exempt obligations for purposes f section 265(a)(2) of the Code to the extent that the av rage outstanding amount of such obligations ~~equals or is les than the average stockholders' equity of the Association or the taxable year leading up to the Effective Time~~: (i) ob igations purchased prior to the Effective Time pursuant to the authority contained in subsection (d)(1)(B) and (C) of section 439 of the Higher Education Act and as to

which the income is exempt from taxation under the Internal Revenue Code of 1986, as amended, and (ii) tax exempt obligations acquired after the Effective Time pursuant to section (d)(1)(B) and (C) in connection with contractual commitments for future purchases that are outstanding as of the Effective Time. The assets and indebtedness of the Association shall not be considered in any determination under section 265(a)(2) as to whether the Holding Company and its subsidiaries have incurred or continued indebtedness to purchase or carry tax-exempt obligations.

(2) **Basis in assets for tax purposes -** The adjusted basis of any asset held by the Holding Company at the Effective Time shall be the fair market value of that asset as of the Effective Time for all purposes of taxation after that date by any State, territory, possession, Commonwealth or dependency of the United States, or by the District of Columbia, or by any county, municipality or local taxing authority.

step up bases

(3) **Exemption from certain State taxes -** No State, territory, possession, Commonwealth or dependency of the United States, or the District of Columbia, or any county, municipality or local authority may treat any transfer of property from the Association to the Holding Company and/or its Subsidiaries under section 440(c) hereof as resulting in a change of ownership of any property owned by the Association, Holding Company and/or Subsidiaries for purposes of any law of such State, territory, possession, Commonwealth or dependency of the United States, or the District of Columbia, or any county, municipality or local authority providing for reassessment of property on the occurrence of a change of ownership or imposing a tax on the ownership or transfer of property.

no transfer taxes

NEW

(4) **Recognition of gain with respect to FFELP loans -** The Association shall include in its taxable income for the year that includes the last day of the thirty-sixth calendar month immediately following the Effective Time an amount of gain equal to the excess of the present value of all FFELP loans held by the Association on that day over the adjusted basis of those loans on that day. The present value of each FFELP loan held by the Association on that day shall become the adjusted basis of that loan for Federal income tax purposes.

"(8) **Monitoring of Safety and Soundness** -

(1) **Obligation to obtain, maintain, and report informa ion** - The Association shall obtain such information and mak and keep such records as the Secretary of the Treasur may from time to time prescribe concerning the Associa ion's policies, procedures, or systems for monitoring and controlling financial risk to it resulting from the activit es of any of its associated persons, to the extent such ac ivities are reasonably likely to have a material impact n the financial condition of the Association, including its capital ratio, its liquidity, or its ability to conduct and finance its operations; provided, however, that the Ass ciation's obligations under this subsection with respect t any associated person which is a third party service (as defined in 34 C.F.R. §682.200(b)) shall be limited to providing to the Secretary of the Treasury copies of any reports or other information provided to the Secretary f Education pursuant to 24 C.F.R. §682.200 et seq. The Sec retary of the Treasury may require summary reports of such ir formation to be filed no more frequently than quarterly.

(2) **Definition** - For purposes of the subsection, the ter "associated person" shall mean any person, other than a atural person, directly or indirectly controlling, contro] led by, or under common control with the Association."

"(9) **Association Board of Directors** - Notwithstandi any other provision of Part B of Title IV of the Higher Education Act [20 U.S.C. § 1071 et seq.], after the Effect ve Time, the 14 directors of the Association elected by the Association's stockholders (which immediately after the Ef ective Time shall be the Holding Company) shall no longer be required to meet the eligibility requirements set forth n section 439(c).

"(10) **Issuance of Stock Warrants** - At the Effective T me, the Holding Company shall issue to the Secretary of [Tr asury/Education] the following stock warrants, each entitl ng the holder of the stock warrant to purchase from the Ho ding Company one share of the common stock of the Holdin Company at the Exercise Price on or before the Exerci e Date. The stock warrants shall be transferable to

new

Non merging

?

another party by the Secretary in minimum multiples of [X] upon no ice to the company.

Number f Warrants	Exercise Date
[X]	December 31, 1997
[X]	December 31, 1998
[X]	December 31, 1999
[X]	December 31, 2000
[X]	December 31, 2001
[X]	December 31, 2002
[X]	December 31, 2003
[X]	December 31, 2004

does this limit right to hold? w/ real stock warrants

The Exe :cise Price of the stock warrants shall be an amount equal t › (1) the average closing price of the common stock of the iolding Company for the 20 business days prior to and includi ıg the effective date of this Act on the exchange or market which is then the primary exchange or market for the common stock of the Holding Company plus (2) ten percent of the ave :age price described in the ~~preceding~~ clause. In the event t ıat the effective date is a date on which the primary exchang ı or market for the common stock of the Holding Compan is closed, the market price for that date shall be deemed :o be the market price on the next succeeding date on which ı ıch exchange or market is open.

Lee?

"(d) I ischarge of Remaining Obligations, Liquidation and Dissolı tion of the Association - The Association shall dissolı ı and its separate existence shall terminate on Decembı : 31, 2004, after discharge of its Remaining Obligations ı ıd liquidation pursuant to this subsection. The Associı :ion may dissolve pursuant to this subsection prior to Decı mber 31, 2004 by notifying the Secretary of Education of its intention to dissolve, unless within 60 days of receipı of such notice the Secretary notifies the Association tl at it continues to be needed to serve as a lender of last rı sort pursuant to section 439(q) of the Higher Education Aı t [20 U.S.C. § 1087-2 (q)]. On the Dissolution Date, the As: ociation shall take the following actions:

(1) **Establishment of a Trust** - The Association shall, under the terms of an irrevocable trust agreement in form and substance satisfactory to the Association and the appointed trustee, irrevocably transfer the Remaining Obligations to the trust and irrevocably deposit or cause to be deposited into such trust the following assets, as trust funds solely for the benefit of holders of the Remaining Obligations:

(A) money or non-callable obligations of or guaranteed by the United States of America or any agency thereof for which payment the full faith and credit of the United States is pledged, maturing as to principal and interest in such amounts and at such times as are sufficient without consideration of any significant reinvestment of such interest to pay the principal of and interest on such Remaining Obligations to stated maturity,

(B) securities or financial assets (~~which may include student loans~~) in such amounts and of such kind as to ensure the highest credit rating from a nationally recognized bond rating agency for such trust, and as to which the Holding Company shall agree to take all actions necessary to maintain such rating, or

(C) a combination of (A) and (B).

All money, obligations or financial assets deposited into the trust pursuant to this subsection shall be applied by the trustee to the payment of the obligations assumed by the trust. Upon the fulfillment of the trustee's obligations under the trust, any remaining assets of the trust shall be transferred to the Holding Company and/or its Subsidiaries, as directed by the Holding Company.

(2) **Obligations Not Transferred to the Trust** - The Association shall make proper provision under applicable state law (which, in the absence of any other applicable law shall be deemed the District of Columbia law) for all other obligations of the Association (including the repurchase or redemption or the making of proper provision for the repurchase or redemption on or prior to December 31, 2004 of any preferred stock of the Association then outstanding).

(3) **Transfer of Remaining Assets and Liabilities** - The Association shall transfer to the Holding Company and/or its Subsidiaries, as directed by the Holding Company, all remaining assets and liabilities of the Association not deposited in the trust.

"(e) **Operation of the Holding Company.**

"(1) **Registration Statement** - For the purposes of determining whether the Holding Company is a registrant entitled under 17 C.F.R. §239.13, or any successor regulation, to use SEC Form S-3, or any successor form, for registration of its securities under the Securities Act of 1933, as amended [15 U.S.C. § 77a-77aa (1988)], the Holding Company shall be deemed to have met the conditions set forth in Instruction I(A)(3) of 17 C.F.R. § 239.13.

"(2) **Holding Company Board of Directors** - The number and composition of the Board of Directors of the Holding Company shall be determined as set forth in the Holding Company's charter or like instrument (as amended from time to time) or by-laws (as amended from time to time) and as permissible under the laws of the jurisdiction of its incorporation.

"(3) **Holding Company Name** - The names of the Holding Company and any direct or indirect subsidiary of the Holding Company may contain (~~to the extent~~ permitted by the applicable ~~State or District~~ of Columbia law), "Student Loan Marketing Association", ~~or~~ "Sallie Mae", ~~or~~ variations thereof or such other name ~~as the~~ Board of Directors of the Association or the Holding Company shall deem appropriate.

"(f) **Strict Construction** - Except as specifically set forth in this Act, nothing contained herein shall be construed to limit the authority of the Association as a federally chartered corporation, or of the Holding Company as a State or District of Columbia chartered corporation.

"(g) **Deadline for Effective Time** - Section 440 [20 U.S.C. § 1087-3] shall be of no further force and effect in the event that the Effective Time does not occur on or before 18 months after the effective date of this Act.

"(h) Technical Amendments.

"(1) Amendments to the Higher Education Act - As of the Effective Time, the Higher Education Act [20 U.S.C. § 1071 et seq.] shall be amended by inserting after "Student Loan Marketing Association" in subsections 435(d)(1)(F) and (G) [20 U.S.C. §§ 1085(d)(1)(F) and (G)] and subsection 428C(a)( )(A)[20 U.S.C. § 1078-3(a)(1)(A)] the following: "or the holding company of the Student Loan Marketing Association, including all subsidiaries of such holding company, created pursuant to the Student Loan Marketing Association Transition Act of 1995."

"(2) Repeal of the Association's Charter - Upon the Dissolution Date, section 439 of Part B of Title IV of the Higher Education Act [20 U.S.C. § 1087-2] shall be deemed to be repealed.

"(I) Definitions.

For purposes of this Act -

(1) The term "Association" means the Student Loan Marketing Association.

(2) The term "Dissolution Date" shall mean December 3 , 2004 or such earlier date as the Secretary of Education permits the transfer of Remaining Obligations in accordance with section 440(d) [20 U.S.C. § 1087-3(d).

(3) The term "Effective Time" means the effective time of the Reorganization as determined by the Board of Directors of the Association, which shall not be earlier than the date that stockholder approval is obtained pursuant to section 440(b) [20 U.S.C. § 1087-3(b)] hereof and shall not be later than the date that is 18 months after the effective date of this Act.

(4) The term "Holding Company" means the new business corporation formed by the Association under the laws of any State of the United States or the District of Columbia.

(5) The term "Remaining Obligations" shall mean the debt obligations of the Association outstanding as of the Dissolution Date.

(6) The term "Remaining Property" shall mean the following assets and liabilities of the Association which are outstanding as of the Effective Time: (i) debt obligations issued by the Association, (ii) contracts relating to interest rate, currency or commodity positions or protections, (iii) investment securities owned by the Association, (iv) any instruments, assets or agreements described in section 439(d) of the Higher Education Act (including without limitation all student loans, forward purchase and lending commitments, warehousing advances, academic facilities obligations, letters of credit, standby bond purchase agreements, liquidity agreements, and student loan revenue bonds or other loans), and (v) except as specifically prohibited by this Act, any other nonmaterial assets or liabilities of the Association which the Association's Board of Directors determines to be necessary or appropriate to its operations.

(7) The term "Reorganization" means the restructuring event or events (including any merger event) giving effect to the holding company structure described in Section 440(a).

(8) The term "Subsidiaries" shall mean one or more direct or indirect subsidiaries of the Holding Company.

SEC. 4. EFFECTIVE DATE.

Except as otherwise explicitly provided in any provision of this Act, this Act and the amendments made by this Act shall take effect on the date of enactment of this Act.

DEPARTMENT OF THE TREASURY

WASHINGTON

15th & PENNSYLVANIA AVENUE, NW

WASHINGTON, DC 20220

FACSIMILE COVER SHEET

DATE May 11

NUMBER OF PAGES TO FOLLOW: 8

TO: Bill Galston

ADDRESSEE'S FAX NUMBER: 456-2878

FROM: Darcy Bradbury

SENDER'S FAX NUMBERS: (202) 622-0244

SENDER'S CONFIRMATION NUMBER: 622-1871

COMMENTS/SPECIAL INSTRUCTIONS:

UNCLASSIFIED

SallieMae

JUDY KENNEDY
Assistant Vice President, Government Relations
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007
Telephone: (202) 298-3062
Fax: (202) 298-3199

FACSIMILE TRANSMISSION

Date: 5/10/95

PLEASE DELIVER TO: Darcy Bradbury

COMPANY: Treasury

Phone Number: 622-0265

Number of pages (including cover sheet) 8

Message:

Tim Greene letter to Rep. McKeon

STUDENT LOAN MARKETING ASSOCIATION
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007-3871
202-333-8000

TIMOTHY G. GREENE
Executive Vice President
General Counsel

May 9, 1995

The Honorable Howard P. McKeon
Chairman
Subcommittee on Postsecondary Education,
Training and Life-Long Learning
United States House of Representatives
Washington, D. C. 20515-6100

Dear Chairman McKeon:

We have reviewed a copy of the letter to you from the Department of the Treasury and the Department of Education concerning the Administration's comments on the draft bill under consideration for privatizing Sallie Mae. We want to take this opportunity to respond to the issues the Administration has raised.

As an initial matter, we disagree with the view that the privatization of Sallie Mae is linked to the future of direct lending. As we have noted before, the time has come to privatize Sallie Mae because our underlying mission of creating a strong secondary market in the student loan industry has been accomplished. Today, there is ample liquidity in the market-place. A government-sponsored national secondary market for student loans is no longer needed. This is true regardless of whether current law provisions on implementation of direct lending remains in effect, or are changed to limit or accelerate such implementation. The private capital markets can fully and adequately provide needed liquidity.

The Administration offers several suggestions relating to the financial soundness of the wind-down GSE subsidiary that would result from the proposed legislation. The first is a suggestion that it may be appropriate to raise the statutory capital requirements now applicable to the GSE to a higher level during the wind-down period. We do not believe any increase is warranted since the capital requirements which presently apply to Sallie Mae should be more than adequate for a business with mature assets that is being wound down in an orderly manner. This conclusion is reinforced by the fact that the current requirement is already significantly in excess of the economic capital requirements that would apply to the business in which we are engaged under accepted financial principles. To increase the statutory capital requirement when new risks and obligations are not being added to the GSE subsidiary would be troublesome and unnecessarily hamper the privatization initiative.

Likewise, we have difficulty with the suggestion that the safety and soundness provisions of current law be scrapped in favor of a full and immediate obligation of the new holding company to make up any capital requirement deficit at the GSE subsidiary level. The Congress has determined the safety and soundness provisions which currently apply to Sallie Mae are adequate for a company that is growing and incurring new obligations. The same provisions should be more than adequate for an entity that is winding down. Moreover, the idea that the holding company would have a full obligation to cover any such deficit is inconsistent with stated concerns about assuring separate corporate identities. At the most, it may be appropriate to consider requiring the holding company to return an amount not to exceed any dividends that the GSE has paid to it in the last 6 months in the event of a capital shortfall at the subsidiary level. While we do not believe this provision is needed, or that a shortfall will result, if the Committee wishes to accommodate this concern, suitable language is provided in the attachment to this letter, which contains amendments to the May 8, 1995 draft of the bill.

We are prepared to accept the Administration's suggestion that restrictions on any pledge or transfer of the GSE subsidiary's shares could only be made with agency approval so long as that approval cannot be withheld if the safety and soundness of the GSE is not compromised. We also agree that prior agency approval would be appropriate before any voluntary bankruptcy proceeding for the GSE is begun. Language to this effect has also been included in the attachment.

We believe that many of the Administration's suggestions regarding the maintenance of the firewall between the new holding company and the GSE are adequately addressed by existing principles of corporate law. These principles already require that the parent treat the subsidiary fairly and that transactions between the two be on an arm's-length basis. They also require that the separate corporate identities of the two be protected by the keeping of separate books and records and the maintenance of a clear separation on the funds and other assets of the two entities. Nonetheless, the attachment contains language addressing these issues. We believe that the Administration's concern about overlap of the Boards of Directors of the two corporations is adequately addressed by the provision that would retain seven of the twenty-one positions on the GSE board for presidential appointees. We are willing to accept the Administration's suggestion that at least one officer of the GSE not be an officer or employee of the holding company or its other subsidiaries and have included language to that effect in the attachment.

We would also suggest that Congress has the power to prevent any so-called "substantive consolidation" of the GSE and the holding company in a holding company insolvency situation. This goal could be accomplished by a statutory provision that denies any party in a proceeding under the bankruptcy provisions of the U.S. Code the right to reach the assets of the GSE in fulfillment of the obligations of the parent or its other affiliates without agency approval. We have provided language to implement this mechanism.

We are aware that privatization will need to be budget neutral and, to this effect, we have been working with the Congressional Budget Office and the Joint Committee on Taxation on the proposals we have made to address budget neutrality. We believe that our proposals address the budget scoring issues. Payment of offset fees by the new holding company, which no longer has any federal connection, as suggested by the Admininstration, would not be acceptable to shareholders. The attachment to this letter does contain changes reflecting the results of our most recent discussions about these proposals.

We are prepared to discuss any concerns that the Administration or Congress may have about the terms of the stock warrants that would be given to the government as part of privatization. These discussions will have to take into account the number of warrants, shareholder dilution concerns and the way in which the Congressional Budget Office scores warrants for budget purposes. However, within those parameters, issues like the timing of exercise, the amounts the government can exercise at any one time and even the exercise price could be discussed. Certainly, we fully expected to provide SEC registration of the stock underlying the warrants.

We also believe that the Administration's concerns regarding the obligations of the holding company with respect to the liabilities of the GSE after the GSE is dissolved can be allayed. The current draft of the bill already provides for holding company assumption of any liabilities of the GSE that are not transferred to the Trust in Section 440(d)(3). We have provided language in the attachment that addresses the other concern raised by the Administration by providing a guarantee by the holding company of the obligations of the Trust.

We disagree with the suggestion regarding the use of the "Sallie Mae" name and logo by the holding company and its other affiliates. We believe that the concern about confusion in the marketplace about securities issued by the two entities is exaggerated. The securities of the existing GSE are all issued in that entity's legal name, the "Student Loan Marketing Association". The new holding company will agree not to use that name. Use by the new entity of the "Sallie Mae" name should be easily distinguishable in the marketplace. We are open to discussion of additional provisions to avoid possible confusion.

We understand and agree with the concern on the use of phrases like "implicit government guarantee" and "Federal agency status" in the bill. The May 8 draft of the bill already deleted these references.

Finally, at the May 3 hearing, some concern was expressed over whether a privatized Sallie Mae would continue to support the FFELP. Larry Hough made it clear that we would continue to do so. This is what we are set up to do. Nonetheless, to address any lingering concern, we have added a provision which authorizes the Secretary to request that the GSE continue to purchase loans if inadequate liquidity exists for FFELP loans.

Once again, thank you for the opportunity to respond to the Administration's concerns. We are, of course, prepared to discuss these and any other questions you may have at any time.

Sincerely,

Timothy G. Greene
Executive Vice President
and General Counsel

Attachment

May 9, 1995

PROPOSED AMENDMENTS TO

SALLIE MAE PRIVATIZATION LEGISLATION

(1) The following sentence is added to the end of section 440(c)(4):

"If, at any time after the reorganization effective date, the Association fails to comply with such capital standards, the Holding Company shall be obligated to transfer to the Association additional capital in such amounts necessary to ensure that the Association again complies with the capital standards, but not to exceed that amount received by the Holding Company as dividends during the six-month period immediately preceding such failure."

(2) The word "and" is deleted at the end of section 440(c)(6)(A). The following words are added to the end of section 440(c)(6):

", and (C) in connection with its purchase of loans insured under this part, if the Secretary, with the approval of the Secretary of the Treasury, requests the Association to continue or resume its secondary market purchase program because the Secretary determines there is inadequate liquidity for loans made under this part, the Secretary is authorized to enter into agreements with the Association covering these additional secondary market activities. Any such agreement shall cover a period of twelve months, but may be renewed if the Secretary determines that liquidity remains inadequate. The fee provided under section 439(h)(7) shall not apply to loans acquired under any such agreement with the Secretary."

(3) The following words are added to the end of the second sentence of section 440(c)(7):

"or with purchasing loans under an agreement with Secretary described in section 440(c)(6)."

(4) In section 440(c)(8)(A)(i), the words "as to which the income is exempt from taxation under the Internal Revenue Code of 1986, as amended, and" are deleted. In section 440(c)(8)(A)(ii), the words "tax exempt" are deleted.

(5) Section 440(c)(8)(D) is renumbered to become section 440(c)(8)(B) and the body of such section is deleted and replaced with the following:

"The Association shall include in its taxable income for the year that includes the last day of the thirty-sixth calendar month immediately following the reorganization effective date an amount of income equal to the present value of the expected future net income on all FFELP loans held by the Association on that day (the "Accelerated Income"). The increase in tax attributable to the Accelerated Income shall be creditable against any future Federal tax liability of the Association other than an employment tax liability."

Section 440(c)(8)(B) is renumbered to become section 440(c)(8)(C) and section 440(c)(8)(C) is renumbered to become section 440(c)(8)(D).

(6) Section 440(c)(9)(B) is moved to become the last sentence of section 440(c)(9)(A) and the following new section 440(c)(9)(B) is added:

"(B) **Maintenance of separate entities** - After the reorganization effective date, the Holding Company and other corporate affiliates of the Association shall take all reasonable actions to: (i) preserve the separate corporate identities of each company within the holding company structure for purposes of any legal or equitable proceeding that could involve the Association, including the maintenance of separate books and records and the separation of the funds and assets of the separate entities, (ii) maintain arms length relationships between the Association and its corporate affiliates, and (iii) maintain independent management between the Association and Holding Company and its other subsidiaries, including the disqualification of at least one officer of the Association from serving as an officer or employee of the Holding Company or such other subsidiaries. Notwithstanding any otherwise applicable Federal or state law, rule or regulation or legal or equitable principle, doctrine or theory to the contrary, under no circumstances shall the assets of (i) the Association be available or used to pay claims or debts of or incurred by the Holding Company or (ii) the Holding Company be available or used to pay claims or debts of or incurred by the Association; provided that nothing contained herein shall limit the right of the Association to pay dividends not otherwise prohibited hereunder or limit any liability of the Holding Company explicitly provided for in this part."

(7) A new section 440(c)(12) is added to read as follows:

"(12) **Restrictions on Transfer of Association Shares and Bankruptcy of Association.**" - After the reorganization effective date, the Holding Company shall not sell, pledge or otherwise transfer the outstanding shares of the Association, or agree to or cause the Association to file bankruptcy, without prior approval of the Secretary of the Treasury; provided, however, that such approval shall not be withheld if, after giving effect to such event, the safety and soundness provisions of Section 439(r) are maintained."

(8) The words "or may be needed to purchase loans under an agreement with the Secretary described in section 440(c)(6)" are added to the end of the second sentence of section 440(d).

(9) The following sentence is added after the first sentence of the last paragraph of section 440(d)(1):

"To the extent that such money, obligations and financial assets are insufficient to pay the obligations assumed by the trust at the time such obligations become due, the Holding Company shall agree to fully and unconditionally guarantee the payment of such obligations."

FAX Transmission

The National Economic Council

The White House

To: Bill Galston

Phone: ______ FAX: 6-6687

From: ELLEN SEIDMAN

Phone: 202-456-2802 FAX: 202-456-2223

Date: ______ Time: ______

Pages to follow: 6

Comments: FYI

05/08/95 09:23 WHITE HOUSE/NEC 002/007

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 5, 1995

The Honorable Howard P. McKeon
Chairman
Subcommittee on Postsecondary Education,
Training, and Life-Long Learning
U.S. House of Representatives
Washington, DC 20515-6100

Dear Chairman McKeon:

Thank you for giving the Departments of Education and Treasury the opportunity to testify at your hearing on May 3 on the privatization of Sallie Mae and Connie Lee. We pledged to work with you and your staff to help develop the best possible legislation to implement these proposals.

In reviewing the draft legislation pertaining to Sallie Mae that you sent to us on the evening of the hearing, we have tried to keep three guiding principles in mind:

-- access to student loans must be protected during the transition from the wholly bank-based Federal Family Education Loan Program (FFELP) to one in which the direct loan program established under the Student Loan Reform Act of 1993 will grow, under current law, to reach at least 60% of the new loan market by 1998 (these technical comments are without regard to pending proposals either to cap or to accelerate that pace);

-- the financial safety and soundness of the GSE must also be protected during the transition as it winds down its operations in order to protect the bondholders and student borrowers and to avoid any possibility that legislation might be needed to prevent a default on the GSE's obligations; and

-- any privatization must be budget-neutral and, moreover, must provide some compensation, which may be in the form of an interest in the new company for the fact that Sallie Mae's relationship to the Government has provided significant benefits to Sallie Mae stockholders for more than two decades.

Privatization of Sallie Mae should proceed only if these principles are adhered to.

We have specific comments on certain provisions of the draft bill as well as some thoughts on certain items, which have not been included in the draft, that would address our foremost concerns.

Protecting student borrowers

Students must be assured of the availability of credit. In this connection, it is imperative that a viable secondary market for FFELP loans continue during the transition period. We are concerned that other secondary markets may not be able to accommodate the demand for secondary market services if guaranteed lending remains a significant portion of the total annual loan volume. Therefore, we believe there should be a linkage between the ramp-up of the direct loan program and privatization. The bill should recognize that we are dealing with two interconnected orderly transitions -- to direct lending and to privatization.

Sallie Mae has a legal obligation to act as a lender of last resort (LLR) under the FFELP. The proposed bill would require the GSE to continue to act as an LLR, but it would permit GSE capital above the statutory minimum to be transferred to a new private company. Such transfers could affect the GSE's capacity to act as an LLR. Also, the current statutory provision would remain in place under which the Secretary of Education can increase the offset fee on the GSE if it does not meet an LLR request. However, the runoff in the GSE portfolio during the transition period would diminish the potential impact of the penalty offset fee. Thus, we believe that additional protection must be included in the legislation to enable the Department of Education to provide eligible students with access to student loans by advancing funds to private lenders for the purpose of making FFELP loans.

Financial safety and soundness

The basic proposal in the draft bill is to permit Sallie Mae to create a new private company (the Holding Company). Sallie Mae, the GSE, would become a wholly owned subsidiary of the Holding Company. Excess capital and other assets of the GSE would be transferred to the Holding Company to enable it to redeploy them for its private business purposes, including participation in the student loan business. The Holding Company and any of its other subsidiaries would be completely private firms without any ties to the Federal Government. Because of the coexistence of the GSE and the Holding Company during the transition period, it is vital that the GSE's financial safety and soundness be protected. The draft legislation does not accomplish this result.

Transfer of Capital from the GSE: We are concerned that the dividend provision of the proposed bill (new subsection 440(c)(3)) would permit capital to be transferred too rapidly

from the GSE to the Holding Company at the beginning of the transition period. The only constraint proposed for payment of dividends would appear to be compliance with the GSE capital ratio in current law (subsection 439(r)). We are concerned that, if capital is withdrawn too rapidly in the early years, the Holding Company would need to return capital to the GSE in the latter part of the transition period to meet the statutory capital ratio.

Requiring the Holding Company to recapitalize the GSE is a risk to both the GSE and the taxpayers. The Holding Company would need to either shrink its business operations or raise new outside capital to be able to recapitalize the GSE and maintain its own capital at levels needed to obtain an investment grade credit rating. We prefer a less risky approach. We would relate withdrawals of capital from the GSE to the ramp-up of the direct loan program and thus provide more adequately for the financial integrity of the GSE as well as adequate capital for purchases of FFELP loans during the transition period.

Firewalls to protect GSE: We believe that it is crucial for the bill to contain firewalls to insulate the GSE from the possible financial failure of the Holding Company during the transition period. The financial failure of the Holding Company could affect the GSE in two different ways:

a) It could have a direct effect on the GSE's ability to meet its obligations. For example, if the Holding Company is servicing loans for the GSE, the financial failure of the Holding Company could cause disruption in the flow of funds to the GSE; and

b) Even if the GSE continued to be solvent, a Holding Company bankruptcy could lead creditors of the Holding Company to attempt to reach assets of the GSE through "substantive consolidation", a legal theory under which the assets of related entities may be consolidated in bankruptcy, even where only one of the entities is insolvent.

There are numerous ways to diminish or eliminate these risks. These would include imposing restrictions or prohibitions on transactions between the GSE and the Holding Company or any of its affiliates. Another solution would be to require Federal agency approval of all such transactions, or of a specific category of transactions such as loan servicing agreements. The possibility of substantive consolidation would also be reduced if the bill imposes an affirmative obligation for the separate identity of the GSE to be preserved. This should cover a variety of matters, including requirements to maintain separate books and records and to maintain funds and assets of the GSE separate from funds and assets of the Holding Company or any of its other

05/08/95 09:25 WHITE HOUSE/NEC 005/007

affiliates, as well as providing that the assets of the GSE may be used only to fulfill obligations of the GSE. Other provisions should include precluding a complete overlap of the Boards of Directors of the GSE and the Holding Company and requiring that at least one executive officer of the GSE is not also an officer or employee of the Holding Company.

Limit Sale of GSE Stock: In addition to these restrictions, we believe the bill should ensure that during the transition period, the stock of the GSE could not be pledged or transferred without prior Federal agency approval. The bill also should ensure that the Holding Company could not agree to or cause the GSE to file for bankruptcy without prior agency approval. Although these may seem remote possibilities, we believe it is important to retain oversight of the GSE's future for so long as it exists.

Enhanced Oversight of GSE During Transition: The draft bill would leave the capital restoration plan provisions in current statute (subsection 439(r)) unchanged. However, the current statutory provisions are designed for an on-going GSE and their implementation would take too much time to be practical to protect the GSE during the transition. Therefore, we prefer an approach that would require the Holding Company to restore the capital of the GSE immediately any time the capital ratio dropped below the statutory threshold. We would also raise the statutory threshold modestly as the GSE's business winds down to achieve a greater margin of financial soundness for the GSE at a time when its business operations would be changing sharply. This would have minimal financial impact on the Holding Company, since the assets against which the capital is measured would be reduced significantly.

<u>Budget neutrality and Federal participation in the success of the Holding Company</u>

The tax-related subsection of the draft bill regarding recognition of gain with respect to FFELP loans (proposed subsection 440(c)(7)(4)) appears to be intended to provide for the budget neutrality of privatization. We are not certain that this is the intent of this provision or that the proposed acceleration of the recognition of income for tax purposes would compensate the Government for the potential loss of offset fee revenues as a result of privatization. In this connection, we would want to discuss this provision fully with Committee staff, CBO, and OMB and to review the assumptions that underlie any present value calculations. It may be simpler to agree on the amount of offset fees that will be lost and to require the Holding Company to pay them to the Federal Government each year over a 5-year budget period.

The stock warrants subsection of the draft bill is incomplete, overly restrictive, and an inadequate exit fee to compensate

taxpayers for the benefit to stockholders of the GSE's relationship with the Federal Government over the years. The time period to exercise the warrants -- whose number is unstated -- is confined to the transition period, when they could be expected to have the least value. The excessive exercise price and the apparent requirement that the warrants be sold in small quantities over a long period would virtually ensure low returns to the taxpayer. Moreover, the Holding Company would have no obligation to register the warrants or otherwise to facilitate the sale.

Other significant provisions

The bill does not effectively provide that the Holding Company has final responsibility for ensuring that all obligations of the GSE are satisfied. Specifically, the bill should require that the Holding Company provide assets, if necessary, to the trust which will ultimately ensure payment of debt obligations of the GSE that are still outstanding as of the date of dissolution. The bill should also provide that any other obligations of the GSE that cannot be fully satisfied as of the date of dissolution become liabilities of the Holding Company.

We also believe it is important to differentiate between securities issued by the GSE and those of the Holding Company, especially during the transition period. Permitting the Holding Company or any of its non-GSE subsidiaries to use the Sallie Mae name, logo, or facsimile thereof -- as the draft apparently would -- could cause investors to confuse the two types of securities and facilitate fraudulent trading activity.

Any reference to an "implicit Government guarantee" and the "Federal agency status" of GSE obligations should be deleted. The use of these terms in statute is misleading and risks increasing Government responsibility for the GSE.

We appreciate the opportunity to comment on your draft bill. As you can see from our comments, we have serious concerns about the adequacy of protection afforded the U.S. Government, current Sallie Mae bondholders, and the liquidity of the student loan market in the draft as it now reads. This is an extremely complex and significant undertaking. The Administration working group on this subject has been drafting legislation with a team of lawyers and experts in the student loan business and finance for the past several months. Given Congress' priority on this matter, we have accelerated our work and would have a draft to share with you in the near future. Our draft includes many of the provisions in your draft bill, but it has substantial additional protection in the areas noted above.

05/08/95 09:27 → WHITE HOUSE/NEC ☑007/007

We look forward to working with you and your staff on this important undertaking. The first ever privatization of a major financial GSE will create milestones and possible precedents that will be looked to in the years to come. We want to work with you to ensure that this transition is orderly, deliberate, and successful.

The Office of Management and Budget has advised that there is no objection, from the standpoint of the President's program, to the submission of this report to Congress.

Sincerely,

Darcy Bradbury Leo Kornfeld

Darcy Bradbury
Deputy Assistant Secretary
(Federal Finance)
U.S. Department of the Treasury

Leo Kornfeld
Senior Advisor to the
Secretary for Direct Loans
U.S. Department of Education

FAX Transmission

The National Economic Council

The White House

To: Bill Galston

Phone: ______ FAX: 6-6687

From: ELLEN SEIDMAN

Phone: 202-456-2802 FAX: 202-456-2223

Date: ______ Time: ______

Pages to follow: 6

Comments: FYI

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 5, 1995

The Honorable Howard P. McKeon
Chairman
Subcommittee on Postsecondary Education,
Training, and Life-Long Learning
U.S. House of Representatives
Washington, DC 20515-6100

Dear Chairman McKeon:

Thank you for giving the Departments of Education and Treasury the opportunity to testify at your hearing on May 3 on the privatization of Sallie Mae and Connie Lee. We pledged to work with you and your staff to help develop the best possible legislation to implement these proposals.

In reviewing the draft legislation pertaining to Sallie Mae that you sent to us on the evening of the hearing, we have tried to keep three guiding principles in mind:

-- access to student loans must be protected during the transition from the wholly bank-based Federal Family Education Loan Program (FFELP) to one in which the direct loan program established under the Student Loan Reform Act of 1993 will grow, under current law, to reach at least 60% of the new loan market by 1998 (these technical comments are without regard to pending proposals either to cap or to accelerate that pace);

-- the financial safety and soundness of the GSE must also be protected during the transition as it winds down its operations in order to protect the bondholders and student borrowers and to avoid any possibility that legislation might be needed to prevent a default on the GSE's obligations; and

-- any privatization must be budget-neutral and, moreover, must provide some compensation, which may be in the form of an interest in the new company for the fact that Sallie Mae's relationship to the Government has provided significant benefits to Sallie Mae stockholders for more than two decades.

Privatization of Sallie Mae should proceed only if these principles are adhered to.

We have specific comments on certain provisions of the draft bill as well as some thoughts on certain items, which have not been included in the draft, that would address our foremost concerns.

Protecting student borrowers

Students must be assured of the availability of credit. In this connection, it is imperative that a viable secondary market for FFELP loans continue during the transition period. We are concerned that other secondary markets may not be able to accommodate the demand for secondary market services if guaranteed lending remains a significant portion of the total annual loan volume. Therefore, we believe there should be a linkage between the ramp-up of the direct loan program and privatization. The bill should recognize that we are dealing with two interconnected orderly transitions -- to direct lending and to privatization.

Sallie Mae has a legal obligation to act as a lender of last resort (LLR) under the FFELP. The proposed bill would require the GSE to continue to act as an LLR, but it would permit GSE capital above the statutory minimum to be transferred to a new private company. Such transfers could affect the GSE's capacity to act as an LLR. Also, the current statutory provision would remain in place under which the Secretary of Education can increase the offset fee on the GSE if it does not meet an LLR request. However, the runoff in the GSE portfolio during the transition period would diminish the potential impact of the penalty offset fee. Thus, we believe that additional protection must be included in the legislation to enable the Department of Education to provide eligible students with access to student loans by advancing funds to private lenders for the purpose of making FFELP loans.

Financial safety and soundness

The basic proposal in the draft bill is to permit Sallie Mae to create a new private company (the Holding Company). Sallie Mae, the GSE, would become a wholly owned subsidiary of the Holding Company. Excess capital and other assets of the GSE would be transferred to the Holding Company to enable it to redeploy them for its private business purposes, including participation in the student loan business. The Holding Company and any of its other subsidiaries would be completely private firms without any ties to the Federal Government. Because of the coexistence of the GSE and the Holding Company during the transition period, it is vital that the GSE's financial safety and soundness be protected. The draft legislation does not accomplish this result.

Transfer of Capital from the GSE: We are concerned that the dividend provision of the proposed bill (new subsection 440(c)(3)) would permit capital to be transferred too rapidly

from the GSE to the Holding Company at the beginning of the transition period. The only constraint proposed for payment of dividends would appear to be compliance with the GSE capital ratio in current law (subsection 439(r)). We are concerned that, if capital is withdrawn too rapidly in the early years, the Holding Company would need to return capital to the GSE in the latter part of the transition period to meet the statutory capital ratio.

Requiring the Holding Company to recapitalize the GSE is a risk to both the GSE and the taxpayers. The Holding Company would need to either shrink its business operations or raise new outside capital to be able to recapitalize the GSE and maintain its own capital at levels needed to obtain an investment grade credit rating. We prefer a less risky approach. We would relate withdrawals of capital from the GSE to the ramp-up of the direct loan program and thus provide more adequately for the financial integrity of the GSE as well as adequate capital for purchases of FFELP loans during the transition period.

Firewalls to protect GSE: We believe that it is crucial for the bill to contain firewalls to insulate the GSE from the possible financial failure of the Holding Company during the transition period. The financial failure of the Holding Company could affect the GSE in two different ways:

a) It could have a direct effect on the GSE's ability to meet its obligations. For example, if the Holding Company is servicing loans for the GSE, the financial failure of the Holding Company could cause disruption in the flow of funds to the GSE; and

b) Even if the GSE continued to be solvent, a Holding Company bankruptcy could lead creditors of the Holding Company to attempt to reach assets of the GSE through "substantive consolidation", a legal theory under which the assets of related entities may be consolidated in bankruptcy, even where only one of the entities is insolvent.

There are numerous ways to diminish or eliminate these risks. These would include imposing restrictions or prohibitions on transactions between the GSE and the Holding Company or any of its affiliates. Another solution would be to require Federal agency approval of all such transactions, or of a specific category of transactions such as loan servicing agreements. The possibility of substantive consolidation would also be reduced if the bill imposes an affirmative obligation for the separate identity of the GSE to be preserved. This should cover a variety of matters, including requirements to maintain separate books and records and to maintain funds and assets of the GSE separate from funds and assets of the Holding Company or any of its other

affiliates, as well as providing that the assets of the GSE may be used only to fulfill obligations of the GSE. Other provisions should include precluding a complete overlap of the Boards of Directors of the GSE and the Holding Company and requiring that at least one executive officer of the GSE is not also an officer or employee of the Holding Company.

Limit Sale of GSE Stock: In addition to these restrictions, we believe the bill should ensure that during the transition period, the stock of the GSE could not be pledged or transferred without prior Federal agency approval. The bill also should ensure that the Holding Company could not agree to or cause the GSE to file for bankruptcy without prior agency approval. Although these may seem remote possibilities, we believe it is important to retain oversight of the GSE's future for so long as it exists.

Enhanced Oversight of GSE During Transition: The draft bill would leave the capital restoration plan provisions in current statute (subsection 439(r)) unchanged. However, the current statutory provisions are designed for an on-going GSE and their implementation would take too much time to be practical to protect the GSE during the transition. Therefore, we prefer an approach that would require the Holding Company to restore the capital of the GSE immediately any time the capital ratio dropped below the statutory threshold. We would also raise the statutory threshold modestly as the GSE's business winds down to achieve a greater margin of financial soundness for the GSE at a time when its business operations would be changing sharply. This would have minimal financial impact on the Holding Company, since the assets against which the capital is measured would be reduced significantly.

<u>Budget neutrality and Federal participation in the success of the Holding Company</u>

The tax-related subsection of the draft bill regarding recognition of gain with respect to FFELP loans (proposed subsection 440(c)(7)(4)) appears to be intended to provide for the budget neutrality of privatization. We are not certain that this is the intent of this provision or that the proposed acceleration of the recognition of income for tax purposes would compensate the Government for the potential loss of offset fee revenues as a result of privatization. In this connection, we would want to discuss this provision fully with Committee staff, CBO, and OMB and to review the assumptions that underlie any present value calculations. It may be simpler to agree on the amount of offset fees that will be lost and to require the Holding Company to pay them to the Federal Government each year over a 5-year budget period.

The stock warrants subsection of the draft bill is incomplete, overly restrictive, and an inadequate exit fee to compensate

taxpayers for the benefit to stockholders of the GSE's relationship with the Federal Government over the years. The time period to exercise the warrants -- whose number is unstated -- is confined to the transition period, when they could be expected to have the least value. The excessive exercise price and the apparent requirement that the warrants be sold in small quantities over a long period would virtually ensure low returns to the taxpayer. Moreover, the Holding Company would have no obligation to register the warrants or otherwise to facilitate the sale.

Other significant provisions

The bill does not effectively provide that the Holding Company has final responsibility for ensuring that all obligations of the GSE are satisfied. Specifically, the bill should require that the Holding Company provide assets, if necessary, to the trust which will ultimately ensure payment of debt obligations of the GSE that are still outstanding as of the date of dissolution. The bill should also provide that any other obligations of the GSE that cannot be fully satisfied as of the date of dissolution become liabilities of the Holding Company.

We also believe it is important to differentiate between securities issued by the GSE and those of the Holding Company, especially during the transition period. Permitting the Holding Company or any of its non-GSE subsidiaries to use the Sallie Mae name, logo, or facsimile thereof -- as the draft apparently would -- could cause investors to confuse the two types of securities and facilitate fraudulent trading activity.

Any reference to an "implicit Government guarantee" and the "Federal agency status" of GSE obligations should be deleted. The use of these terms in statute is misleading and risks increasing Government responsibility for the GSE.

We appreciate the opportunity to comment on your draft bill. As you can see from our comments, we have serious concerns about the adequacy of protection afforded the U.S. Government, current Sallie Mae bondholders, and the liquidity of the student loan market in the draft as it now reads. This is an extremely complex and significant undertaking. The Administration working group on this subject has been drafting legislation with a team of lawyers and experts in the student loan business and finance for the past several months. Given Congress' priority on this matter, we have accelerated our work and would have a draft to share with you in the near future. Our draft includes many of the provisions in your draft bill, but it has substantial additional protection in the areas noted above.

We look forward to working with you and your staff on this important undertaking. The first ever privatization of a major financial GSE will create milestones and possible precedents that will be looked to in the years to come. We want to work with you to ensure that this transition is orderly, deliberate, and successful.

The Office of Management and Budget has advised that there is no objection, from the standpoint of the President's program, to the submission of this report to Congress.

Sincerely,

Darcy Bradbury
Deputy Assistant Secretary
(Federal Finance)
U.S. Department of the Treasury

Leo Kornfeld
Senior Advisor to the
Secretary for Direct Loans
U.S. Department of Education

05/08/95 11:02 001/002

DEPARTMENT OF THE TREASURY
WASHINGTON

15th & PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20220

FACSIMILE COVER SHEET

DATE May 8, 1995

NUMBER OF PAGES TO FOLLOW: 6

TO: Bill Galston

ADDRESSEE'S FAX NUMBER: 456-2878

FROM: Jill Ousley

SENDER'S FAX NUMBERS: (202) 622-0244

SENDER'S CONFIRMATION NUMBER:

COMMENTS/SPECIAL INSTRUCTIONS:

UNCLASSIFIED

DEPARTMENT OF THE TREASURY
WASHINGTON 20220

May 5, 1995

The Honorable Howard P. McKeon
Chairman
Subcommittee on Postsecondary Education,
Training, and Life-Long Learning
U.S. House of Representatives
Washington, DC 20515-6100

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 5, 1995

The Honorable Howard P. McKeon
Chairman
Subcommittee on Postsecondary Education,
Training, and Life-Long Learning
U.S. House of Representatives
Washington, DC 20515-6100

Dear Chairman McKeon:

Thank you for giving the Departments of Education and Treasury the opportunity to testify at your hearing on May 3 on the privatization of Sallie Mae and Connie Lee. We pledged to work with you and your staff to help develop the best possible legislation to implement these proposals.

In reviewing the draft legislation pertaining to Sallie Mae that you sent to us on the evening of the hearing, we have tried to keep three guiding principles in mind:

-- access to student loans must be protected during the transition from the wholly bank-based Federal Family Education Loan Program (FFELP) to one in which the direct loan program established under the Student Loan Reform Act of 1993 will grow, under current law, to reach at least 60% of the new loan market by 1998 (these technical comments are without regard to pending proposals either to cap or to accelerate that pace);

-- the financial safety and soundness of the GSE must also be protected during the transition as it winds down its operations in order to protect the bondholders and student borrowers and to avoid any possibility that legislation might be needed to prevent a default on the GSE's obligations; and

-- any privatization must be budget-neutral and, moreover, must provide some compensation, which may be in the form of an interest in the new company for the fact that Sallie Mae's relationship to the Government has provided significant benefits to Sallie Mae stockholders for more than two decades.

Privatization of Sallie Mae should proceed only if these principles are adhered to.

We have specific comments on certain provisions of the draft bill as well as some thoughts on certain items, which have not been included in the draft, that would address our foremost concerns.

Protecting student borrowers

Students must be assured of the availability of credit. In this connection, it is imperative that a viable secondary market for FFELP loans continue during the transition period. We are concerned that other secondary markets may not be able to accommodate the demand for secondary market services if guaranteed lending remains a significant portion of the total annual loan volume. Therefore, we believe there should be a linkage between the ramp-up of the direct loan program and privatization. The bill should recognize that we are dealing with two interconnected orderly transitions -- to direct lending and to privatization.

Sallie Mae has a legal obligation to act as a lender of last resort (LLR) under the FFELP. The proposed bill would require the GSE to continue to act as an LLR, but it would permit GSE capital above the statutory minimum to be transferred to a new private company. Such transfers could affect the GSE's capacity to act as an LLR. Also, the current statutory provision would remain in place under which the Secretary of Education can increase the offset fee on the GSE if it does not meet an LLR request. However, the runoff in the GSE portfolio during the transition period would diminish the potential impact of the penalty offset fee. Thus, we believe that additional protection must be included in the legislation to enable the Department of Education to provide eligible students with access to student loans by advancing funds to private lenders for the purpose of making FFELP loans.

Financial safety and soundness

The basic proposal in the draft bill is to permit Sallie Mae to create a new private company (the Holding Company). Sallie Mae, the GSE, would become a wholly owned subsidiary of the Holding Company. Excess capital and other assets of the GSE would be transferred to the Holding Company to enable it to redeploy them for its private business purposes, including participation in the student loan business. The Holding Company and any of its other subsidiaries would be completely private firms without any ties to the Federal Government. Because of the coexistence of the GSE and the Holding Company during the transition period, it is vital that the GSE's financial safety and soundness be protected. The draft legislation does not accomplish this result.

Transfer of Capital from the GSE: We are concerned that the dividend provision of the proposed bill (new subsection 440(c)(3)) would permit capital to be transferred too rapidly

from the GSE to the Holding Company at the beginning of the transition period. The only constraint proposed for payment of dividends would appear to be compliance with the GSE capital ratio in current law (subsection 439(r)). We are concerned that, if capital is withdrawn too rapidly in the early years, the Holding Company would need to return capital to the GSE in the latter part of the transition period to meet the statutory capital ratio.

Requiring the Holding Company to recapitalize the GSE is a risk to both the GSE and the taxpayers. The Holding Company would need to either shrink its business operations or raise new outside capital to be able to recapitalize the GSE and maintain its own capital at levels needed to obtain an investment grade credit rating. We prefer a less risky approach. We would relate withdrawals of capital from the GSE to the ramp-up of the direct loan program and thus provide more adequately for the financial integrity of the GSE as well as adequate capital for purchases of FFELP loans during the transition period.

Firewalls to protect GSE: We believe that it is crucial for the bill to contain firewalls to insulate the GSE from the possible financial failure of the Holding Company during the transition period. The financial failure of the Holding Company could affect the GSE in two different ways:

a) It could have a direct effect on the GSE's ability to meet its obligations. For example, if the Holding Company is servicing loans for the GSE, the financial failure of the Holding Company could cause disruption in the flow of funds to the GSE; and

b) Even if the GSE continued to be solvent, a Holding Company bankruptcy could lead creditors of the Holding Company to attempt to reach assets of the GSE through "substantive consolidation", a legal theory under which the assets of related entities may be consolidated in bankruptcy, even where only one of the entities is insolvent.

There are numerous ways to diminish or eliminate these risks. These would include imposing restrictions or prohibitions on transactions between the GSE and the Holding Company or any of its affiliates. Another solution would be to require Federal agency approval of all such transactions, or of a specific category of transactions such as loan servicing agreements. The possibility of substantive consolidation would also be reduced if the bill imposes an affirmative obligation for the separate identity of the GSE to be preserved. This should cover a variety of matters, including requirements to maintain separate books and records and to maintain funds and assets of the GSE separate from funds and assets of the Holding Company or any of its other

affiliates, as well as providing that the assets of the GSE may be used only to fulfill obligations of the GSE. Other provisions should include precluding a complete overlap of the Boards of Directors of the GSE and the Holding Company and requiring that at least one executive officer of the GSE is not also an officer or employee of the Holding Company.

Limit Sale of GSE Stock: In addition to these restrictions, we believe the bill should ensure that during the transition period, the stock of the GSE could not be pledged or transferred without prior Federal agency approval. The bill also should ensure that the Holding Company could not agree to or cause the GSE to file for bankruptcy without prior agency approval. Although these may seem remote possibilities, we believe it is important to retain oversight of the GSE's future for so long as it exists.

Enhanced Oversight of GSE During Transition: The draft bill would leave the capital restoration plan provisions in current statute (subsection 439(r)) unchanged. However, the current statutory provisions are designed for an on-going GSE and their implementation would take too much time to be practical to protect the GSE during the transition. Therefore, we prefer an approach that would require the Holding Company to restore the capital of the GSE immediately any time the capital ratio dropped below the statutory threshold. We would also raise the statutory threshold modestly as the GSE's business winds down to achieve a greater margin of financial soundness for the GSE at a time when its business operations would be changing sharply. This would have minimal financial impact on the Holding Company, since the assets against which the capital is measured would be reduced significantly.

<u>Budget neutrality and Federal participation in the success of the Holding Company</u>

The tax-related subsection of the draft bill regarding recognition of gain with respect to FFELP loans (proposed subsection 440(c)(7)(4)) appears to be intended to provide for the budget neutrality of privatization. We are not certain that this is the intent of this provision or that the proposed acceleration of the recognition of income for tax purposes would compensate the Government for the potential loss of offset fee revenues as a result of privatization. In this connection, we would want to discuss this provision fully with Committee staff, CBO, and OMB and to review the assumptions that underlie any present value calculations. It may be simpler to agree on the amount of offset fees that will be lost and to require the Holding Company to pay them to the Federal Government each year over a 5-year budget period.

The stock warrants subsection of the draft bill is incomplete, overly restrictive, and an inadequate exit fee to compensate

taxpayers for the benefit to stockholders of the GSE's relationship with the Federal Government over the years. The time period to exercise the warrants -- whose number is unstated -- is confined to the transition period, when they could be expected to have the least value. The excessive exercise price and the apparent requirement that the warrants be sold in small quantities over a long period would virtually ensure low returns to the taxpayer. Moreover, the Holding Company would have no obligation to register the warrants or otherwise to facilitate the sale.

Other significant provisions

The bill does not effectively provide that the Holding Company has final responsibility for ensuring that all obligations of the GSE are satisfied. Specifically, the bill should require that the Holding Company provide assets, if necessary, to the trust which will ultimately ensure payment of debt obligations of the GSE that are still outstanding as of the date of dissolution. The bill should also provide that any other obligations of the GSE that cannot be fully satisfied as of the date of dissolution become liabilities of the Holding Company.

We also believe it is important to differentiate between securities issued by the GSE and those of the Holding Company, especially during the transition period. Permitting the Holding Company or any of its non-GSE subsidiaries to use the Sallie Mae name, logo, or facsimile thereof -- as the draft apparently would -- could cause investors to confuse the two types of securities and facilitate fraudulent trading activity.

Any reference to an "implicit Government guarantee" and the "Federal agency status" of GSE obligations should be deleted. The use of these terms in statute is misleading and risks increasing Government responsibility for the GSE.

We appreciate the opportunity to comment on your draft bill. As you can see from our comments, we have serious concerns about the adequacy of protection afforded the U.S. Government, current Sallie Mae bondholders, and the liquidity of the student loan market in the draft as it now reads. This is an extremely complex and significant undertaking. The Administration working group on this subject has been drafting legislation with a team of lawyers and experts in the student loan business and finance for the past several months. Given Congress' priority on this matter, we have accelerated our work and would have a draft to share with you in the near future. Our draft includes many of the provisions in your draft bill, but it has substantial additional protection in the areas noted above.

6

We look forward to working with you and your [illegible] on this important undertaking. The first ever privatization of a major financial GSE will create milestones and possible precedents that will be looked to in the years to come. We want to work with you to ensure that this transition is orderly, deliberate, and successful.

The Office of Management and Budget has advised that there is no objection, from the standpoint of the President's program, to the submission of this report to Congress.

Sincerely,

Darcy Bradbury
Deputy Assistant Secretary
(Federal Finance)
U.S. Department of the Treasury

Leo Kornfeld
Senior Advisor to the
Secretary for Direct Loans
U.S. Department of [illegible]

DEPARTMENT OF THE TREASURY

(If Received INCOMPLETE call (202) 622-2222)

(CLASSIFICATION)

2793

DATE: 3-10-95

TO:	(Name) Bill Galston	(Ofc Phone #) 202 456-2999
		FAX Nr. ~~202 456-29~~ (Verify) 456-2878

FROM:	Virginia Rutledge	GB	202 622-0480
	(Name)	(Office Symbol)	(Phone #)

HANDLE AS:

ROUTINE	PRIORITY	URGENT

PAGE 1 OF 38 PAGE(s)

NOTE: - Single Pages ONLY - DO NOT Staple - Provide Clear Copy
Number ALL Pages (Original Not Returned)

REMARKS/SUBJECT

COMCEN USE ONLY - DO NOT WRITE BELOW

Sender's FAX Number: (202) 622-2599

R & D - TOR

SSN NUMBER: 2793

DEPARTMENT OF THE TREASURY

(If Received INCOMPLETE call (202) 622-2222)

2791

(CLASSIFICATION)

DATE: 3-10-95

TO: (Name) Barry White | (Ofc Phone #) 202 395-4632 | FAX Nr. 202 395-4875 (Verify)

FROM: Virginia Rutledge (Name) | GB (Office Symbol) | 202-622-0480 (Phone #)

HANDLE AS: ROUTINE | PRIORITY | URGENT

PAGE 1 OF 38 PAGE(S)

NOTE: - Single Pages ONLY - DO NOT Staple - Provide Clear Copy
Number ALL Pages (Original Not Returned)

REMARKS/SUBJECT

COMCEN USE ONLY - DO NOT WRITE BELOW

Sender's FAX Number: (202) 622-2599

R & D - TOR

SSN NUMBER: 2791

DISCUSSION DRAFT

A BILL

To amend the Higher Education Act of 1965 to provide for the implementation of the William D. Ford Federal Direct Loan Program by Fiscal Year 1997, to provide for orderly termination of the status of the Student Loan Marketing Association as a government-sponsored enterprise and its reorganization as a nonfederally-chartered business corporation, to require the return of certain Federal Funds held in reserve by guaranty agencies under the Federal Family Education Loan Program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 1. SHORT TITLE.

This Act may be cited as "The Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Reorganization Act of 1993."

SEC. 2. FINDINGS AND PURPOSE.

(a) Findings.--The Congress hereby finds that--

(1) the William D. Ford Federal Direct Loan Program provides substantially greater benefits to borrowers, participating institutions of higher education, and taxpayers than the Federal Family Education Loan Program, including--

(A) a simpler and speedier process through which to obtain loans, which, by reducing processing time and using electronic data and funds transfers, improves the level of service to students, and frees up institutional administrative personnel for more important duties, such as counseling students regarding financial aid;

(B) a single servicer throughout the life of the loan, which enables the borrower to send one payment, or a single request deferment or forbearance, for all Direct Loans to one place, regardless of the number of loans or where they were originated;

(C) flexible repayment options, including income contingent repayment, which, by varying loan repayments in relation to income encourages Americans to pursue post-secondary education and mitigates the impact of student loan repayments on students' decisions about whether to pursue lower-paying careers, such as public service; and

(D) the elimination of the delays,

inefficiencies, and confusion inherent in the complicated interrelationships of the many lenders, guaranty agencies, secondary markets, and loan servicers the Federal Family Education Loan Program;

(2) the Department of Education's performance in managing the Direct Loan phase-in is viewed very favorably by borrowers and participating institutions alike, and the Department has demonstrated its commitment to the Direct Loan program and devoted the necessary resources--through hiring or reassigning personnel, increased training and technical assistance, and upgraded technology--to ensure the program's success and the Department's capacity to manage a full-scale student loan program;

(3) accelerating the phase-in of the Direct Loan Program would achieve significant additional savings compared to the phase-in schedule in current law, would enable large numbers of students, their parents, and participating institutions to enjoy the benefits of the Direct Loan Program far more quickly than under the current schedule, and would enable the Department to focus more resources on the Direct Loan Program more quickly, rather than dividing those resources between the duplicative systems needed to oversee two large student loan programs simultaneously, one guaranteed and one direct.

(4) full implementation of the Direct Loan Program

creates an environment that no longer will require a government-sponsored enterprise to serve as a secondary market and warehousing facility for Federal Family Education Loans, following a transition period during which the Student Loan Marketing Association will continue to provide credit for students.

(5) over $1.5 billion in Federal funds are held or controlled by guaranty agencies [or their transferees?] as reserves under the Federal Family Education Loan Program;

(6) reserves under that program were intended to assist in the establishment of the guaranty agency system, and to ensure that the guaranty agencies would be financially able to carry out their responsibilities in connection with the guarantees issued by such agencies;

(7) section 432(o) of the Higher Education Act of 1965 clarifies that the Secretary is the ultimate insurer of all guarantees under that program, eliminating the underlying need for most reserve funds; and

(8) the orderly transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program would be benefitted by systematically phasing out many guaranty agency operations and the recall by the Secretary of Education of most reserve funds in the manner that the Secretary determines would best meet the needs of the Federal Family Education Loan Program, assist in the

transition to the William D. Ford Federal Direct Loan Program, and protect the Federal fiscal interest.

(b) Purposes.--It is the purpose of this Act--

(1) to accelerate the transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program so that by academic year 1997-1998, Direct Loans represent 100 percent of the new student loan volume under both programs, and no new loan guarantees will be made by the Secretary under the Federal Family Education Loan Program after June 30, 1997;

(2) to provide for the orderly termination of the existence of the Association as a government-sponsored enterprise on or before December 31, 2000, and to authorize its reorganization as a nonfederally-chartered business corporation; and

(3) to require, as part of the systematic phase-out of guaranty agency operations during the transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program, the Secretary of Education to recall at least $1.1 billion in reserves held or controlled by guaranty agencies (or their transferees) over the period fiscal years 1996 through 2000.

TITLE I--DIRECT LOAN PROGRAM AMENDMENTS

SEC. 101. ACCELERATION OF DIRECT LOAN IMPLEMENTATION SCHEDULE.

Section 453(a) of the Higher Education Act of 1965 (20 U.S.C. 1001 et seq., hereinafter in this Act referred to as "the Act") is amended--

(a) in paragraph (2) by amending subparagraphs (C) and (D) to read as follows:

"(C) for academic year 1996-1997, loans made under this part shall represent 80 percent of the new student loan volume for such year; and

"(D) for academic year 1997-1998 and succeeding academic years, loans made under this part shall represent 100 percent of the new student loan volume for such years."; and

(b) in paragraph (3), by striking out "subparagraphs (C) or (D)" and inserting in lieu thereof "subparagraph (C)".

SEC. 102. TAX TREATMENT OF INCOME CONTINGENT DIRECT LOANS.

(a) Section 455(e)(4) of the Act is amended--

(1) by inserting immediately following the paragraph heading the subparagraph designation "(A)"; and

(2) by adding at the end thereof the following new subparagraph:

"(B) If, after 25 years of repayment [**NOTE: there is still an unresolved issue as to whether the 25 year period will be specifically mentioned.**], there is a balance (which may consist of unpaid principal, accrued interest, and any fees, late charges, and collection costs assessed on such loan) remaining on a loan made under this part that is being repaid pursuant to income contingent repayment, such remaining balance shall be canceled, and such amount canceled shall not be considered income for purposes of the Internal Revenue Code of 1986."

TITLE II -- REORGANIZATION OF THE STUDENT LOAN MARKETING ASSOCIATION

SEC. 201. REORGANIZATION OF THE STUDENT LOAN MARKETING ASSOCIATION.

Part B of Title IV of the Act is amended by adding at the end thereof the following new section:

SEC. 440. REORGANIZATION OF THE STUDENT LOAN MARKETING ASSOCIATION THROUGH FORMATION OF HOLDING COMPANY

(a) Reorganization of the Association.--

(1) Authority to Reorganize.--The Student Loan Marketing Association (hereinafter referred to as the "Association") is authorized to carry out a restructuring of the common stock ownership of the Association, as set forth in a plan of reorganization adopted by the Board of Directors (the "Plan") (the terms of which shall be consistent with this Act) so

that all of the outstanding common shares shall be directly owned by an ordinary business corporation chartered under State or District of Columbia law (the "Holding Company"), as the Board of Directors may determine. The reorganization shall occur as of the effective time set forth in the Plan (the "Effective Time"), which shall be no later than [the date that is 18 months after the effective date of this Act].

(2) Issuance of Warrants to the United States.--The Plan shall provide for the issuance of stock purchase warrants or other instruments in such amounts and on such terms and conditions as are acceptable to the Secretary of the Treasury under which the United States may participate in the gains of the Holding Company or its security holders.

(3) Plan Approval.--Upon adoption of the Plan by the Board of Directors of the Association, the Plan shall be submitted to the Secretary of the Treasury and the Secretary of Education. The Secretary of the Treasury and the Secretary of Education, in their sole discretion, may require the Board to adopt such amendments as are necessary or appropriate to ensure the continued safety and soundness of the Association, consistency with the provisions of this section, and the ability of the Association to continue to fulfill

the purposes for which it was formed until its dissolution.

(4) Stockholder Approval.--

(A) After adoption of the Plan by the Board of Directors with any amendments required in accordance with paragraph (3), the Plan shall be submitted to the common stockholders of the Association for their approval. The Reorganization shall occur at the Effective Time, provided that the Plan has been approved by the affirmative votes, cast in person or by proxy, of the holders of a majority of the shares of the common stock of the Association.

(B) Notwithstanding section 439(1), any proxy solicitation of common stockholders of the Association shall be conducted in accordance with section 14 of the Securities Exchange Act of 1934 and rules and regulations thereunder.

(5) Board Authority.--The Board of Directors of the Association may take or cause to be taken all such action as is consistent with this section and as it deems necessary or appropriate to effect the Reorganization in accordance with this section, applicable State law, and the Plan. Such actions may include, in the Board's discretion, a merger of a

wholly-owned subsidiary of the Holding Company with and into the Association, which would have the effect provided in the Plan and the law of the jurisdiction in which such subsidiary is incorporated. As part of the restructuring, the Board of Directors may cause the common shares of the Association to be converted, at the Effective Time, to common shares of the Holding Company on a one for one basis, consistent with applicable State or District of Columbia law.

(b) Operation of Association and Holding Company During Transition.--

(1) Continuation of Rights and Duties.--Except as specifically provided herein [need more specificity], during the period from the Effective Time until the Dissolution Date (the "Transition Period"), the Association shall continue to have the rights, privileges, duties and obligations set forth in, and shall be subject to the limitations and restrictions of, section 439, and the Association shall continue to carry out the purposes for which it was formed.

(2) Management and Operational Support.--The Holding Company (or its subsidiaries other than the Association) shall provide all necessary and appropriate management and operational (including loan servicing) support to the Association, as requested by

the Association. The Association may also obtain such management and operational support from other persons or entities. Servicing agreements between the Association and the Holding Company or any of its Subsidiaries shall be on terms no less favorable to the Association than the Association could obtain from an unrelated third-party and shall be subject to the approval of the Secretary of the Treasury and the Secretary of Education.

(3) Issuance of Obligations by the Association During the Transition Period.--

(A) As of the Effective Time, the Association shall not issue new debt obligations which mature later than December 31, 2004. Notwithstanding the foregoing, nothing in this subsection shall modify the attributes accorded the debt obligations of the Association by section 439, regardless of whether such debt obligations are incurred prior to or at any time following the Effective Time or are transferred to a trust in accordance with subsection 440(c).

(B) Limitation on Obligations Outstanding.-- After the Effective Time, the Association shall not incur indebtedness which at any given time would exceed the aggregate book value of its assets, to the extent such assets are permitted to be held under this subsection.

(4) Restrictions on New Business Activity or Acquisition of Assets by Association.--After the Effective Time, the Association shall not engage in any new business activities or acquire any new assets other than in connection with--

(A) contractual commitments for future student loan purchases or warehousing advances or pursuant to letters of credit or standby bond purchase agreements in either case which are outstanding as of the Effective Time; and

(B) its serving as a lender of last resort pursuant to section 439.

(5) Limitation on Liquidity Portfolio.--The Association's portfolio of liquid assets and cash equivalents may not exceed five percent of total assets.

(6) Restrictions on Transactions with Affiliates.--The Association shall not extend credit to the Holding Company or any of its affiliates nor guarantee or provide any credit enhancement to any obligations of the Holding Company or any of its affiliates.

(7) Dividends.--

(A) The Association may pay dividends in the form of cash or non-cash distributions provided that--

(i) immediately after payment of such dividends, the Association's capital is in compliance with section 439(t)(4) [Subsection (r) is redesignated as (t) in section 202(b) below.]; and

(ii) the Secretary of Education and the Secretary of the Treasury have approved the Association's certification under subparagraph (C) below.

(B) The aggregate amount of dividends paid from Excess Capital, as defined below in subparagraph (D), may not exceed--

(i) through December 31, 1997, a percentage of Excess Capital equal to the percentage provided under subsection 453(a)(2)(B) of the Act;

(ii) through December 31, 1998, a percentage of Excess Capital equal to the percentage provided under subsection 453(a)(2)(C) of the Act; and

(iii) through December 31, 1999, a percentage of Excess Capital equal to the percentage provided under subsection 453(a)(2)(D) of the Act.

(C) Prior to any payment of a dividend, the Association shall certify to the Secretary of the Treasury that the payment of the dividend will be in compliance with this paragraph and shall provide copies of all calculations needed to make such certification. The calculation of Excess Capital shall be based upon audited financial statements of the Association as of the most recent quarter ending prior to the Effective Time.

(D) For purposes of this paragraph, "Excess Capital" means stockholders' equity as of the day before the Effective Time that is in excess of the amount required to comply with the capital ratio as defined in subsection 439(t).

(E) After the effective date of this Act, any distribution of non-cash assets by the Association to the Holding Company shall be valued at book value on the date the Association's Board of Directors approved such distribution for purposes of the distribution and calculating compliance with section 439(t)(4).

(8) Holding Company Activities.--During the Transition Period, Holding Company activities shall be

limited to ownership of the Association and any other subsidiaries or other business entities that the Holding Company may form or acquire. All business activities shall be conducted through such subsidiaries or other business entities.

(9) Holding Company Name.--The names of the Holding Company and any other direct or indirect subsidiary of the Holding Company other than the Association may not contain the words "Student Loan Marketing Association", or "Sallie Mae", or any variations thereof.

(10) Registration Statement.--For the purposes of determining whether the Holding Company is a registrant entitled under 17 C.F.R. § 239.13, or any successor regulation, to use SEC Form S-3, or any successor form, for registration of its securities under the Securities Act of 1933, as amended, the Holding Company shall be deemed to have met the conditions set forth in Instruction I(A)(3) of 17 C.F.R. §239.13.

(11) Separate Operation of Corporations.--

(A) The funds and assets of the Association shall at all times be maintained separately from the funds and assets of the Holding Company or any of its other subsidiaries and may be used solely by the Association to carry out its purposes and to fulfill its obligations.

(B) The Association shall maintain books and records that clearly reflect the assets and liabilities of the Association, separate from the assets and liabilities of the Holding Company or any of its other subsidiaries.

(C) The Association shall maintain a corporate office that is physically separate from any office of the Holding Company or any of its subsidiaries.

(D) The Holding Company may not transfer or pledge the stock of the Association without the prior approval of the Secretary of the Treasury.

(E) The Holding Company may not cause or agree to the liquidation of the Association nor cause the Association to file a petition for bankruptcy under Title 11 of the United States Code without the prior approval of the Secretary of Education and the Secretary of the Treasury.

(F) No director of the Association that is appointed by the President pursuant to section 439(c)(1)(A) may serve as a director of the Holding Company.

(G) At least one executive officer of the Association shall remain an officer solely of the

Association.

(H) The Secretary of the Treasury may order the Association or the Holding Company to take any action the Secretary determines to be necessary or appropriate to ensure that the corporate separateness of the Association is maintained.

(12) [Tax Matters.--

(A) The following obligations shall not constitute tax-exempt obligations for purposes of section 265(a)(2) of the Code to the extent that the average outstanding amount of such obligations equals or is less that the average stockholders' equity of the Association at the Effective Time--

(i) obligations purchased prior to the Effective Time pursuant to the authority contained in subsection (d)(a)(B) and (C) of section 439 and as to which the income is exempt from taxation under the Internal Revenue Code of 1986, as amended (the "Code"), and

(ii) tax exempt obligations acquired after the Effective Time pursuant to section (d)(1)(B) and (C) in connection with contractual commitments for future purchases that are outstanding as of the Effective

Time.]

(B) [The assets and indebtedness of the Association shall not be considered in any determination under section 265(a)(2) as to whether the Holding Company and its subsidiaries have incurred or continued indebtedness to purchase or carry tax-exempt obligations.] [To be checked with Tax Policy.]

(c) Termination of Association.--The Association shall dissolve and its separate existence shall terminate on the December 31, 2004, after discharge of all outstanding debt obligations and liquidation pursuant to this subsection. The Association may dissolve pursuant to this subsection prior to such date with the approval of the Secretary of Education and the Secretary of the Treasury. On the dissolution date, the Association shall take the following actions:

(1) The Association shall, under the terms of an irrevocable trust agreement in form and substance satisfactory to the Secretary of the Treasury, the Association and the appointed trustee, irrevocably transfer all outstanding debt obligations of the Association to the trust and irrevocably deposit or cause to be deposited into such trust, to be held as trust funds solely for the benefit of holders of the

Remaining Obligations, money or direct non-callable obligations of the United States of America or any agency thereof for which payment the full faith and credit of the United States is pledged, maturing as to principal and interest in such amounts and at such times as are determined by the Secretary of the Treasury to be sufficient without consideration of any significant reinvestment of such interest to pay the principal of, and interest on, such obligations in accordance with their terms. To the extent the Association cannot provide obligations in the amount required, the Holding Company shall be required to transfer obligations to the trust in the amount necessary to prevent any deficiency.

(2) All money, obligations or financial assets deposited into the trust pursuant to this subsection shall be applied by the trustee to the payment of the obligations assumed by the trust. Upon the fulfillment of the trustee's obligations under the trust, any remaining assets of the trust shall be transferred to the Holding Company and/or its Subsidiaries, as directed by the Holding Company.

(3) The Association shall make proper provision [under applicable State law (which, in the absence of any other applicable law shall be deemed New York [or

Delaware law])] for all other obligations of the Association (including the repurchase or redemption, or the making of proper provision for the repurchase or redemption, of any preferred stock of the Association then outstanding). Any obligations of the Association which cannot be fully satisfied shall become obligations of the Holding Company as of the Dissolution Date.

(4) After compliance with paragraph (1), (2) and (3) and with approval of the Secretaries of Education and Treasury, the Association shall transfer to the Holding Company and/or its Subsidiaries, as directed by the Holding Company, any remaining assets of the Association.

(d) [OPTION 1: Reorganization Fee.--In partial recognition of the substantial benefits that accrued to the Association as a result of its status as a government-sponsored enterprise, the Association [correct entity?] shall, as a condition of its reorganization as a private business corporation without a federal charter, pay to the general fund of the Treasury] OR OPTION 2: Compensation for Lost Federal Revenues.--To offset the loss of revenues that would have been paid to the Federal Government if the Association retained its status as a government-sponsored enterprise, the Association [correct entity?] shall, as a condition of its reorganization as a private business corporation without a federal charter, pay to the general fund of the Treasury--

(1) $X for fiscal year 1996;

(2) $X for fiscal year 1997;

(3) $X for fiscal year 1998;

(4) $X for fiscal year 1999; and

(5) $X for fiscal year 2000;

minus any amount paid by the Association pursuant to section 439(h)(7) for such fiscal year, except that in no case shall such subtraction result in a negative number.".

SEC. 202. AMENDMENTS TO SECTION 439

(a) Sec. 439 of the Higher Education Act of 1965 is amended--

(1) by amending subsection (c)(1) to read as follows:

"(c)(1) Composition of Board; Chairman.-- The Association shall have a Board of Directors which shall consist of 12 persons, three of whom shall be appointed by the President and shall be representative of the general public. The remaining 9 directors shall be elected by the common stockholders of the Association entitled to vote pursuant to subsection (f) of this section. Four of the elected directors shall be affiliated with an eligible institution; and five of the elected directors shall be affiliated with an eligible lender.

(2) by amending the heading of subsection (r) as follows:

"(r) SAFETY AND SOUNDNESS OF ASSOCIATION AND ORDERLY TRANSITION PURSUANT TO SECTION 440.--";

(3) by amending subsection (r)(1) to read as follows:

"(1) FINANCIAL REPORTING.--

"(A) The Holding Company shall promptly furnish to the Secretary of Education and the Secretary of the Treasury copies of all public financial reports publicly distributed by the Holding Company.

"(B) Within 45 days of the end of each calendar quarter, the Association shall provide to the Secretary of the Treasury [and the Secretary of Education] (1) financial statements of the Association and (2) a report showing the calculation of the capital ratio in a form and containing such information as is approved by the Secretary.

"(C) The Association shall obtain such information and make and keep such records as the Secretary of the Treasury may from time to time prescribe concerning the Association's policies, procedures, or systems for monitoring and controlling financial risk to it resulting from the activities of any of its associated persons, to the extent such activities are reasonably likely to have a material impact on the financial condition of the Association, including its capital ratio, its liquidity, or its ability to conduct and finance its operations. The term "associated person" shall mean any person other than a natural person, directly or indirectly controlling, controlled by, or under common control with the Association."

(4) in subsection (r)(2) by adding at the end thereof the following new subparagraph:

"(D) The Secretary may establish and collect from the Association an annual assessment in an amount sufficient to provide for reasonable costs and expenses of the Secretary to carry out the duties of the Secretary under this subsection and section 440.";

[Purpose of audits may need to be expanded to cover more than financial safety and soundness.]

(5) by amending subsection (r)(3) in the second sentence by inserting "." after "of such determination" and deleting the remainder of the sentence.

(6) by amending subsection (r)(4) to read as follows:

"(4) If the capital ratio is less than 3.0

percent at the end of the Association's most recent calendar quarter, the Secretary of the Treasury may, until the capital ratio equals or exceeds 3.0 percent, take any one or more of the following actions:

(A) LIMIT INCREASE IN LIABILITIES.--[no change from language in current law, subsection (7) (A)]

(B) RESTRICT GROWTH.--[no change]

(C) RESTRICT DISTRIBUTIONS.--[no change]

(D) REQUIRED ISSUANCE OF NEW CAPITAL.--[no change]

(E) LIMIT EXECUTIVE COMPENSATION.--[no change]

(F) REQUIRED INJECTION OF NEW CAPITAL.--Require the Holding Company to inject additional capital into the Association";

(7) by deleting paragraphs (5) through (11);

(8) by redesignating paragraphs (12) and (13) as paragraphs (5) and (6) respectively.

(9) by amending paragraph (6) as redesignated by--

(A) deleting subparagraph (A) and renumbering subparagraphs (B) and (C) as subparagraphs (A) and (B), and

(B) [by adding at the end the following new definition: Add definition dealing with treatment of securitized assets for purposes of capital ratio.].

(b) Section 439 of the Act is further amended--

(1) in subsection (q) --

(A) in paragraph (1) (B), by striking out "to this subsection" and "paragraph (2) (A) of this subsection" and inserting in lieu thereof "to this paragraph" and "subparagraph (B) (i) of this paragraph," respectively;

(B) by redesignating paragraph (1), and subparagraphs (A) and (B) thereof, as subparagraph (A), and clauses (i) and (ii) thereof, respectively;

(C) by redesignating paragraph (2), and subparagraphs (A) and (B) thereof, as subparagraph (B), and clauses (i) and (ii) thereof, respectively;

(D) by redesignating paragraph (3) as subparagraph (C);

(E) by inserting immediately after the subsection heading the following: "(1) LENDER-OF-LAST-RESORT LOANS MADE BY THE ASSOCIATION FROM ITS OWN FUNDS.--;" and

(F) by adding at the end thereof the following new paragraph:

"(2) ADVANCES TO THE ASSOCIATION FOR LENDER-OF-LAST-RESORT SERVICES.--(A)(i) In order to ensure the availability of loan capital during the transition from the Federal Family Education Loan Program under this part to the William D. Ford

Federal Direct Loan Program under part D of this title, the Secretary is authorized to provide the Association with advance funds, with such restrictions on the use of such funds (including conditions relating to the time or times of repayment) as are determined appropriate by the Secretary, to enable the Association to make loans as the lender-of-last-resort whenever the Secretary determines that eligible borrowers are seeking and are unable to obtain loans under this part.

(ii) Notwithstanding any other provision of law, the Secretary may provide such advances to the Association without regard to the availability of a lender-of-last-resort program of a guaranty agency operating in that State.

(iii) The Association shall make such loans in accordance with this subsection and the requirements of the Secretary. The Secretary may require that the Association make loans to borrowers within a geographic area or for the benefit of students attending institutions of higher education that certify, in accordance with standards established by the Secretary, that their students are seeking and unable to obtain loans.

(iv) Notwithstanding any other provision in this part, the Association shall be required to pay to the Secretary, at such intervals as the Secretary may specify, interest on the funds advanced pursuant to this paragraph in an amount equal to the interest paid by the borrowers of loans made pursuant to this paragraph.

"(B) Loans made pursuant to this paragraph shall be insurable by the Secretary under section 429 with a certificate of comprehensive insurance coverage provided for under section 429 (b) (1).

"(C) Notwithstanding any other provision in this part, the Secretary shall pay the Association a fee, in an amount established by the Secretary is consultation with the Association, in conjunction with the Association, for making such lender-of-last-resort loans in lieu of interest and special allowance subsidies, and the Association shall assign such loans to the Secretary on demand. Upon such assignment, the portion of the advance represented by the loans assigned shall be considered repaid by the Association.

"(D) The Secretary may make the advances and pay the fees described in this paragraph from funds available under this part or under section 458 of the Act."

(2) by redesignating subsections (r) [and (s)] as subsections (t) [and (u)], respectively; and

(3) by inserting immediately after subsection (q) the following new subsections:

"(r) ADVANCES TO THE ASSOCIATION FOR LOAN PURCHASES.--(1) Whenever the Secretary determines that it is necessary to the successful transition from the Federal Family Education Loan Program under this part to the William D. Ford Federal Direct Loan Program under part D of this title, the Secretary is authorized to provide the Association with advance funds, which the Association shall use to purchase loans made under this part that are insured by a guaranty agency.

"(2) Loans purchased pursuant to this subsection shall be insurable by the Secretary under section 429, with a certificate of comprehensive insurance coverage provided for under section 429 (b) (1), in lieu of the insurance provided by a guaranty agency prior to such purchase.

"(3) Notwithstanding any other provision in this part, the Association shall be required to pay to the Secretary, at such intervals as the Secretary may specify, interest on the funds advanced pursuant to this subsection in an amount equal to the interest paid by the borrowers of loans made pursuant to this subsection.

"(4) Notwithstanding any other provision in this part, the Secretary shall pay the Association a fee, in an amount established by the Secretary in consultation with the Association, in lieu of interest and special allowance subsidies on the loans purchased under this subsection, and the Association shall assign such loans to the Secretary on demand. Upon such assignment, the portion of the advance represented by the loans assigned shall be considered repaid by the Association.

"(5) The Secretary may make the advances and pay the fees described in this subsection from funds available under this part or under section 458 of the Act."

SEC. 203. OTHER SECONDARY MARKETS.--

Part B of Title IV of the Act is further amended by adding at the end thereof the following new section:

"SEC. 441. ADVANCES AUTHORIZED.--

(a) PURPOSES.--The Secretary is authorized to make advances to one or more secondary markets described in subsection (b) from funds specified in subsection (c) to enable such secondary market to--

(1) make loans as the lender-of-last-resort on terms consistent with the provisions in section 439 (q) (2) (including fees in lieu of interest and special allowances subsidies, and assignment on demand)

regarding lender-of-last-resort loans by the Student Loan Marketing Association; or

(2) purchase loans made under this part that are insured by a guaranty agency on terms consistent with the provisions in section 439(r) (including fees in lieu of interest and special allowance subsidies, and assignment on demand) regarding such purchases by the Student Loan Marketing Association.

(b) ELIGIBLE SECONDARY MARKET.--In order to be eligible to receive advances under this section, a secondary market must meet the definition of an eligible lender in Section 435 (d) and such other eligibility criteria as the Secretary may specify.

(c) SOURCES OF ADVANCE FUNDS.--The Secretary may make the advances and pay the fees described in this section from funds available under this part or under section 458 of the Act."

SEC. 204. REPEAL OF SECTION 439

Section 439 of the Act shall be repealed as of the date the Association is dissolved pursuant to section 440(c) of the Act, as added by section 201 of this Act.

TITLE III--FEDERAL FAMILY EDUCATION LOAN RESERVE RECOVERY AMENDMENTS

SEC. 301. RECOVERY OF RESERVES.--

(a) Section 422 of the Act is amended--

(1) in subsection (g)(1)--

(A) in the second sentence therein, by inserting "except as provided in subsection (h)," immediately after "However,";

(B) in the third sentence therein, by striking out "The reserves" and inserting in lieu thereof "Reserves not recovered pursuant to subsection (h)";

(C) by striking out subparagraph (A);

(D) in subparagraph (D), by striking out "subparagraph (A) or (B)" and inserting in lieu thereof "subparagraph (A)"; and

(E) by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively; and

(2) by adding at the end thereof the following new subsection:

"(h) RECOVERY OF RESERVES IN FISCAL YEARS 1996 THROUGH 2000.--(1) Notwithstanding any other provision of law, the Secretary shall recover from the reserve funds held by guaranty agencies an aggregate amount that is not less than $350,000,000 for fiscal year 1996, $250,000,000 for each of fiscal years 1997 and

1998, $150,000,000 for fiscal year 1999, and $100,000,000 for fiscal year 2000, except that such annual minimum recovery amounts shall not apply once the Secretary has recovered $1.1 billion under this subsection. The Secretary shall establish criteria for selecting the guaranty agencies that shall be required to return reserve funds, as well as criteria for determining the amount of reserve funds (which shall include the value of any reserve fund assets, and may include reserve funds or assets held by, or under the control of, any other entity) that each guaranty agency selected by the Secretary shall be required to return. Except as provided in paragraph (3), funds returned to the Secretary under this subsection shall be deposited in the Treasury.

"(2) The criteria described in paragraph (1) shall be established by the Secretary after consulting with representatives of the higher education community, and shall be designed to meet the needs of the Federal Family Education Loan Program under this part, assist in the orderly transition from such program to the William D. Ford Federal Direct Loan Program under part D of this title, and protect the Federal fiscal interest.

"(3) If funds in excess of $1.1 billion in the aggregate are returned under this subsection, such excess funds shall be available to the Secretary for use in the orderly transition from the Federal Family Education Loan Program under this part to the William D. Ford Federal Direct Loan Program under part D of this title.".

(b) Section 428 of the Act is amended--

(1) in subsection (b)(1)(X), by striking out "maintains reserve funds determined by the Secretary to be sufficient in relation to such agency's guarantee obligations." and inserting in lieu thereof "maintains a level of financial strength that meets the requirements established by the Secretary pursuant to section 428(c)(9)(A)."; and

(2) in subsection (c)(9)--

(A) by amending the paragraph heading to read as follows: "FINANCIAL STRENGTH OF GUARANTY AGENCIES; TERMINATION OF GUARANTY AGENCY AGREEMENTS.--";

(B) by amending subparagraph (A) to read as follows:

"(A)(i) Notwithstanding any other provision of law, the Secretary is authorized to establish a required level of reserve funds for each guaranty agency that has entered into an agreement with the Secretary pursuant to this subsection. Such reserve requirements shall be designed to meet the needs of the Federal Family Education Loan Program under this part, assist in the orderly transition from such program to the William D. Ford Federal Direct Loan Program under part D of this title, and protect the Federal fiscal interest.

"(ii) If, in carrying out section 422(h), the Secretary determines that the needs of the Federal Family Education Loan Program under this part, the orderly transition from such program to the William D. Ford Federal Direct Loan Program under part D of this title, and the Federal fiscal interest would be better served by a method of providing financial support for guaranty agency operations other than the use of reserve funds, then, notwithstanding any other provision of law, the Secretary is authorized, after consulting with representatives of the higher education community and informing the Congress, to establish such alternate method in lieu of reserves. Such alternate method may include, but shall not be limited to, the provision of working capital to guaranty agencies on a case-by-case basis."; and

(C) in subparagraph (C)(i), by striking out "falls below the required minimum reserve level" and inserting in lieu thereof "fails to meet the financial strength requirements established by the Secretary pursuant to subparagraph (A)".

SEC. 302. FISL AMENDMENTS.

(a) Section 421(a)(1) of the Act is amended--

(1) in subparagraph (a), by striking out the comma at the end thereof and inserting in lieu thereof a semicolon;

(2) in subparagraph (b), by adding at the end thereof the following: "or to a loan made under part D of this title;"; and

(3) in subparagraph (C), by striking out the comma and inserting in lieu thereof a semicolon.

(b) Section 3423 of the Act is amended--

(1) in subsection (a), by striking out the period at the end thereof and inserting in lieu thereof a comma and "or to direct loans under part D of this title."; and

(2) in subsection (b)--

(A) in paragraph (2), by striking out "or" at the end thereof;

(B) in paragraph (3), by striking out the period at the end thereof and inserting in lieu thereof a semicolon and "or"; and

(C) by adding at the end thereof the following new paragraph:

"(4) for the insurance of loans made to student borrowers (or to parents, on behalf of students) in a State where there is not States student loan insurance program for student