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HOUSE OF REPRESENTATIVES
WASHINGTON, D. C. 20515

SAM GEJDENSON
CONNECTICUT

Bill

Thank you for the force on student loan. its been a long Road & this is the help from the W.H. Sam

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United States General Accounting Office

GAO

Report to the Congress

March 1993

FINANCIAL AUDIT

Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

March 30, 1993

NOTE TO SECRETARY RILEY AND DEPUTY SECRETARY KUNIN

Attached is a summary of the main outstanding issues that we need to resolve in order to develop the rest of the student loan reform initiative. We have briefly described each issue and our recommendation. Department staff helped to develop these recommendations. They have provided, in a very short time, valuable input on how to structure the proposed system.

We look forward to discussing these recommendations with you. Please let us know if you need further information.

David A. Longanecker

Maureen A. McLaughlin

703

Attachment

cc:
Mike Smith
Terry Peterson

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

FACSIMILE TRANSMISSION

DATE: March 30, 1993

NUMBER OF PAGES: 7 to follow

TO: Bill Galston

FROM:
Maureen A. McLaughlin
Acting Assistant Secretary
for Postsecondary Education
Department of Education
Room: 4082 Building ROB-3
7th & D Streets SW
Washington, DC 20202-5100
Telephone# 202-708-5547
Fax# 202-708-9814

MESSAGE: Please review and give me a call with any comments.

OUTSTANDING ISSUES IN STUDENT LOAN REFORM

March 30, 1993

IMPLEMENTATION OF DIRECT LOANS

✓ o **Phase-in Period**

The original phase-in period assumed 500 institutions in each of the first two years, 3000 in the third year, and full implementation in FY 1997. An alternative phase-in period would start more quickly with full implementation by the end of FY 1997.

Recommendation: The second phase-in strategy would work well with the new approach of developing strict criteria for loan originators and relying heavily in the beginning on experienced direct lenders in the Perkins program. This phase-in would have 4 percent of volume in direct lending by the end of FY 1994, 25 percent the second year, 60 percent the third year, and full implementation by the end of FY 1997.

✓ o **Criteria to Determine Loan Originator**

Criteria measuring the financial and administrative capability of institutions to originate loans well will be used to determine which institutions can originate themselves and which should use an alternative originator.

Recommendation: In the first phase we will rely heavily on experience in the existing direct loan program, Perkins loans, to pick institutions that can originate loans themselves. Other institutions will be able to use alternative origination services. Institutions will be selected randomly among qualified applicants in the early years according to institutional type and control and level of current lending in the guaranteed student loan program.

The second phase will develop more detailed criteria that measure administrative and financial capacity for participation as an originator.

o **Alternative Originators**

Alternative originators could include the state agencies, private lenders, Sallie Mae and other organizations if they are willing to do so for a fixed fee.

Recommendation: Initially, alternative origination services would be provided through a federal contractor, or through a state that is ready to perform these services immediately. At full implementation, the state agencies would be responsible for this activity. They could do it themselves or they could contract with private organizations.

o **Student Borrower Terms**

The proposal could consolidate loan programs, change loan limits, alter eligibility criteria, and change student interest rates. On the other hand, these changes could be postponed and included in a future initiative addressing all student aid programs.

Recommendation: Lowering the student interest rate at full implementation by about one-half of a percentage point would give some of the savings from direct loans back to the students. Other changes in loan limits and eligibility rules would be included in your next initiative as part of the movement to a student aid maximum and changes in financing proprietary schools.

o **Fees to Loan Originators**

Institutions performing loan origination could be paid a small fee or they could be required to pay any costs themselves.

1 **Recommendation:** Pay institutions a small fee--about $10--that would decline for larger numbers of loans. This would adjust for declining marginal costs of origination. Paying the institutions and the alternative originators a small fee would generate more support for direct lending and would reduce arguments that we are saving money by shifting costs to the institutions. This origination fee would increase federal costs only slightly. 850-60 million

o **Other Programs**

How to treat the revolving accounts in the Perkins loan program is an outstanding issue. We could recapture the federal portion or we could allow institutions to keep all or part of the revolving accounts.

Recommendation: Include this issue as part of your next proposal to address all student aid programs. In the meantime, eliminate any future federal capital contributions to the Perkins program.

FEDERAL STATE PARTNERSHIP

o **Federal/State Partnership**

When fully implemented, the program will represent a true federal/state partnership, with each state that wishes to enter into the partnership negotiating an agreement with the Secretary of Education to establish a genuine state loan agency (SLA). In some states the current guarantee agency may be designated as the new SLA. This new agency will operate as the state's alternate loan originator for institutions that do not act as loan originators, train participating institutions' personnel, monitor participating institutions, and service loans from the point of origination through normal repayment. These agencies will receive fees for the services they provide.

gov't will respond

Recommendation: Endorse the federal/state partnership concept, with implementation developed in two stages. Stage 1 will include states providing the alternate origination, training, and institutional monitoring functions. Stage 2, which will begin when the state can demonstrate capacity to move forward, will include the loan servicing function.

- **Federal/State Risk Sharing**

problems relate to other proposal (line 2)

In association with the fees provided to SLAs for the services they provide, these entities will also receive incentive payments for exceptional performance and financial sanctions for inadequate performance.

Recommendation: Endorse the concept of providing appropriate financial incentives and sanctions to the SLAs.

- **Federal/State Data System**

To work effectively, the various SLAs will need to be able to share data from all loan originators throughout the nation. Therefore, it will be imperative that the Department develop a national student loan data system.

Recommendation: Have the Department of Education develop the national student loan data system.

- **The Federal/State Partnership and Private Vendors**

Both the federal government and the states may choose to contract for specific services with private vendors. For all practical purposes, however, the federal/state partnership will eliminate the financial incentive for the current array of lenders in the guaranteed student loan program, including SALLIE MAE, to remain active vendors in the new program.

Recommendation: Allow the federal government and states to contract for services with private vendors, recognizing that this will likely eliminate participation of most of the lenders and non-profit agencies involved in the current loan program.

INCOME CONTINGENT REPAYMENTS

- **Income Measure**

Income contingent repayments could be based on a variety of income measures including borrower earnings, total family income before exemptions and deductions, and adjusted gross income (after exemptions and deductions).

Recommendation: Family income is the best measure of ability to pay because it includes all sources of income for the family, not just earnings. We also recommend setting aside a portion of income and assessing loan payments based on the remaining "discretionary" income. Our preference is to use total family income before tax exemptions and deductions, with an offset equal to the poverty line adjusted by family size. The specific income measure will depend, however, on the data that IRS can provide to us. We are currently exploring this issue with IRS.

- **Percentage of Income**

A wide variety of repayment schedules could be employed that meet the general description of income contingent. Some would vary the percentage of income that is repaid, some would charge a percentage of income per $1000 borrowed, and others would charge a fixed percentage of income until the loan is repaid.

Recommendation: Adopt a straightforward system that requires borrowers to repay between 5 and 10 percent of discretionary income. The legislation would state that the Secretary will set the specific rate within this range.

- **Capitalization of Interest**

The issue here is whether interest should accrue and be added to the principal when payments are insufficient to cover the interest. The proponents of capitalization argue that borrowers who earn money later in life should not pay less than borrowers with steadier incomes. Opponents, on the other hand, argue that this is unfair to the poor.

Recommendation: We recommend that interest accrue and be capitalized so that borrowers whose incomes grow in future years will repay when their incomes are sufficient. For borrowers with persistently low incomes, interest accrual will be irrelevant because their incomes will never be sufficient to fully repay.

- **Length of Repayment**

Some income contingent plans write off the remaining loan balance after a set number of years, such as 20 or 30 years. Others argue that there should not be a limit on the length of time that borrowers repay because their incomes may increase later in life.

Recommendation: Do not set a limit on the length of time for repayment. Remaining debt would be written off at death.

- **Defaulters**

  Some options require defaulters to repay through income contingency. This would help to ensure that defaulters pay what they can, with the amount varying according to the level of income.

  Recommendation: Require defaulters to repay through income contingency.

- **Conversion**

  Converting guaranteed loans into direct loans would allow us to offer income contingent repayment options to current borrowers. It would also allow students who have both direct and guaranteed loans to consolidate them.

  Recommendation: Buy some student loans and offer those students income contingent repayments. We need to explore further OMB's credit reform scoring rules for this option, particularly for those loans made before 1992.

- **Collector**

  Should the IRS be involved in the collection of student loans and, if so, for which borrowers? The IRS could be involved in a variety of ways: sharing information on income with loan servicers, collecting all student loans, or collecting income contingent loans.

  Recommendation: The first phase of income contingent collections is to use IRS information on income for income contingent collections. Loans would be collected by state agencies or by servicers under contract to the federal government. At the same time the Secretaries of Education and Treasury will develop a plan for full implementation of loan collections, including the appropriate role for IRS. This would allow sufficient time to address all the issues and concerns regarding how such a system would be structured and how much it would cost.

EASING THE TRANSITION FROM GUARANTEED STUDENT LOANS

- **Loan Capital Availability**

  Once it is apparent that the current guaranteed student loan program is being replaced entirely by the new direct student loan program, it is quite possible that some of the current lenders, perhaps even a large share of these lenders, may quit participating in the current program. If this were to occur, it would create a substantial problem with the availability of loan capital. Therefore, the Department of Education must begin immediately to develop a way of assuring adequate loan capital in the event that private capital dries up.

Recommendation: Within the Department, begin immediately to develop a way to ensure adequate availability of capital for guaranteed student loans until the direct student loan program is fully operational.

- **Guarantee Agency Solvency**

  As the volume of loans in the guaranteed student loan program begins to decline, it is almost certain that some current state and non-profit guarantee agencies will become financially insolvent, because they lack adequate reserves to finance their existing contingent liabilities.

  Recommendation: Adopt a new administrative cost allowance that funds agencies on the basis of total outstanding balances, rather than solely on the basis of new annual loan volume, and prepare a plan for absorbing the loan portfolios of guarantee agencies that become insolvent.

- **SALLIE MAE:**

  For all practical purposes, creation of the direct student loan program, particularly one that involves an intentional federal/state partnership, eliminates the need for the secondary market activities currently provided by the Student Loan Marketing Association (SALLIE MAE). Without its past reason for being, SALLIE MAE could evolve in various ways. It could become an entirely private entity by repaying the $5 billion debt to the federal treasury and pursue activities other than student loans. It could repay its $5 billion debt, continue to service a diminishing guaranteed student loan portfolio, and eventually simply go out of existence. Or, it could be absorbed back into the federal government and become the administrator of the direct student loan program.

  Ellen Seidman

  Recommendation: No recommendation is provided at this time on what should become of SALLIE MAE.

March 28, 1993

CURRENT ESTIMATES FOR STUDENT LOAN POLICY

Administration and CBO estimates for the savings for Direct Lending and the student loan State Default Fee in the February 17, 1993 document, "A Vision for Change in America", were based on preliminary concepts and designs. Since then, substantial work has been done to refine policy. This has resulted in a number of revised design parameters that, in turn, result in new cost estimates. The Administration and CBO agree on the general range of cost estimates outlined below.

Direct Lending

The general policy announced on February 17th has not changed: The Administration proposes to modify and expand current law (which authorizes only a pilot direct lending program), with the goal of full implementation of direct lending during FY 1997. Direct lending will be phased in during the intervening period.

- Changes to the CBO estimate of the February 17th policy are the result of specific design changes:

Summary:	1994-1998 outlay savings from baseline ($ in billions)
Original CBO estimate	- 6.1
Modified phase-in path yielding reduced subsidy savings	+ .9
Additional administrative costs (repayment mechanism for income contingency; computer systems; guaranteed lending transition costs)	+ .2
Additional costs for alternative loan origination for schools that do not have sufficient capacity to originate	+ .2
Return some savings to students at full implementation (reduced interest rate)..	+ .6
Revised CBO 5 year savings estimate ...	- 4.2

- Components of the new program design (savings from baseline):

Subsidy savings from phase in (new path) of direct lending	- 7.4
Administrative costs of building up direct lending and income contingent repayment mechanisms	+ 1.7
Administrative costs of phasing down the guaranteed loan programs	+ .9
Reduced interest rate to students at full implementation (on the order of one half percentage point)	+ .6
Revised CBO 5 year savings estimate ...	- 4.2

State default fee

The general policy in the February 17th document for the State default fee has not changed: to provide an incentive to States to improve licensing procedures and oversight of schools in the loan programs. States will be required to share the cost of excess defaults in schools in the State (State costs could be recovered from schools). The goal of the policy is to encourage States to take actions that reduce the incidence of default. It is consistent with Congress' passage in 1992 of a stronger State role in ensuring program integrity.

The proposal is coupled with a discretionary appropriation request to support enhancement of State capacity to oversee high default schools as provided in the 1992 HEA amendments.

The CBO estimate was based on a preliminary implementation design: setting the State share of default costs at half the excess over 20 percent in each school, beginning in FY 1994.

The policy the Administration now will propose retains the same goal. However, it recognizes that States need time to revise systems and procedures and that certain schools need time to adjust to the policy.

The new CBO estimate is based on the modified policy of:

- o delaying start up of the default fee policy until FY 1995; and
- o phasing in the policy over the succeeding four years.

	1994-1998 outlay savings from baseline ($ in billions)
Original CBO estimate	- .6
Change for delayed implementation and slower phase-in	+ .3
Revised CBO 5 year savings estimate......	- .3

REVISED 5 YEAR SAVINGS ESTIMATES:

	1994	1995	1996	1997	1998	1994-1998
Dir. lns.	116	114	- 406	- 1,667	- 2,318	- 4,195
St. fee	0	- 24	- 57	- 106	- 118	- 306
Total	116	90	- 463	- 1,773	- 2,436	- 4,501

MEMORANDUM

To: Bill Galston
Fr: Bob Shireman *BS*
Date: March 31, 1993
Re: **Concerns**

I spoke earlier this evening with Maureen McLaughlin about the direction that the legislative drafting is going. I am very concerned.

The GAO financial audit (attached) shows that the weakest parts of the GSL system are the state guaranty agencies. Yet ED is talking about turning many of the responsibilities in direct lending over to the states, which will certainly assign the tasks to the current guarantors. I will meet with the people at ED to discuss this idea further, but my first reactions are: (1) it would be a disaster, and (2) the governors AND the higher education organizations will oppose it vehemently. I hate to tarnish the student loan/national service bill with a major controversy like this.

I also remain concerned that whatever language comes out of ED on IRS collection will be too weak to get Sen. Simon excited, and certainly too weak to hold our Republican supporters (Petri, as the ranking member on the Subcommittee in the House, is particularly important). I will work with ED on it, but the issue may get kicked up to the White House level.

P.S. I'll get you my reactions to the Sallie Mae proposal by Thursday afternoon.

Sallie Mae's proposal does not address these problems. (And I'm concerned that ED's proposals don't either!)

Fraud and Abuse

Claim: Under direct lending, problem schools will have open access to Federal money.

Response: These schools already have access to Federal funds through any of 8000 different lenders--lenders that have little financial stake in ensuring that the funds are spent wisely. Ensuring that there is only one spigot through which the Federal funds would flow gives the Federal government more control, and more tools for sensing and stopping fraud and abuse.

- Congress and the Education Department have already taken many steps to eliminate schools that do not provide a good education. This process must continue whether we shift to direct lending or not.

- Because schools deal with many different lenders and guaranty agencies, it can take two years or more before the Education Department has complete data on the amount of loans at a school. This has allowed fraud by schools--and by banks--to go undetected for months or years. With direct lending, the Education Department would know about a questionable increase in borrowing at a school *before* that borrowing took place. The Department could seek further information, and, if necessary, turn off the spigot.

- The complexity of the current system makes it very difficult to track loans and Federal subsidy payments. The GAO financial audit of the GSL program (March 1993) concluded that the "Program's structure is not conducive to good financial management." Among the findings:

--"None of the 10 guaranty agencies we visited reconciled quarterly and yearly data and only one reconciled its monthly bills to its quarterly reports submitted to the Department."

--"We compared the information on tape dumps submitted to Education with guaranty agency source documents for 30 randomly selected loans and found that 19 had errors in the reported status of loans and student enrollment."

--"Lender billings to Education often include loans guaranteed by several different guaranty agencies. However, the guaranty agencies we visited limited their reviews [of lenders] to the loans they guaranteed. . .[T]hey could not project an estimate of the accuracy of a lender billing [to the Department] and thus could not provide the Department with assurance that these billings were accurate."

--Discrepancies in data "could result in Education not receiving millions of dollars of loan origination fees owed by lenders."

This complexity and cost is unnecessary and counter-productive.

- I urge anyone defending the current system to read the financial audit of the GSL program, completed just last week by GAO. It concludes that the structure of the guaranty system "is not conducive to good financial management." The report identifies "serious problems in the program's structure," particularly with respect to guaranty agencies:

  --"Guaranty agencies assume little financial risk and are not compensated in a way that provides sufficient incentives to prevent defaults."

  --"[M]any guaranty agencies have expanded their operations to activities that create serious conflicts of interest with their stewardship responsibilities."

  --"By assuming servicing and ownership roles, guaranty agencies are, in effect, responsible for regulating their own activities."

  (For other findings of the GAO audit, see the "fraud and abuse" sheet).

- Direct lending systems would be much simpler than the current system (see second and third charts).

- The analysis of direct lending conducted during the Bush Administration determined that direct loans would be simpler:

  --"A Direct Loan program would be easier to manage and would greatly reduce opportunities for error and abuse. A centralized data base would improve data integrity and auditability. Department monitoring

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United States General Accounting Office

GAO

Report to the Congress

March 1993

FINANCIAL AUDIT

Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement

Bill FYI -Paul J

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

MEMORANDUM

~~CONFIDENTIAL~~

DETERMINED TO BE AN ADMINISTRATIVE MARKING
INITIALS: JAM DATE: 10/2/17
2017-1069-F

March 30, 1993

TO: Billy Webster

FR: Paul Jamieson PWJ

RE: Sallie Mae Market Analysis

BACKGROUND ON SALLIE MAE

The Student Loan Marketing Association (Sallie Mae) is the major secondary market to the nation's education credit community, servicing about a third of all loans to students made in the U.S. Its clients include financial institutions, schools and some state agencies. Chartered by Congress in 1972 to "provide liquidity for originators of student loans made under federally-sponsored student loan programs..." (according to its annual report), Sallie Mae stock has been enormously profitable over the last several years; from 1986 to 1991, costs went down 21 percent while profits soared 172 percent. At the end of 1991, Sallie Mae owned over $22 billion worth of student loans from over 4 million students and parents and over $45 billion in total assets; its 1991 net profit was $345 million -- a 15 percent per share increase from 1990. In addition to student loans, Sallie Mae also provides tax-exempt financing for schools to expand and renew their facilities.

Another player in the education finance community is the Student Loan Corporation, formerly a division of Citicorp. Student Loan is the largest student lender among banks. The day after the State of the Union address, stock from the Rochester-based company, which first sold public shares in December of 1992, fell $3 1/4 to $15 1/2 (over 17 percent). Student Loan is the second largest holder in the servicing market, with 6.5 to 7 percent of market share.

There are also 40 state secondary markets, who currently act as "mini Sallie Maes" by servicing loans made by small local lenders. These agencies are generally thinly-capitalized, with about half of their $2 billion (total) in tax-exempt bond issues at risk. In the event that these agencies go out of business under the proposal, states would be financially responsible to bond holders (see proposed strategy at conclusion).

OVERVIEW

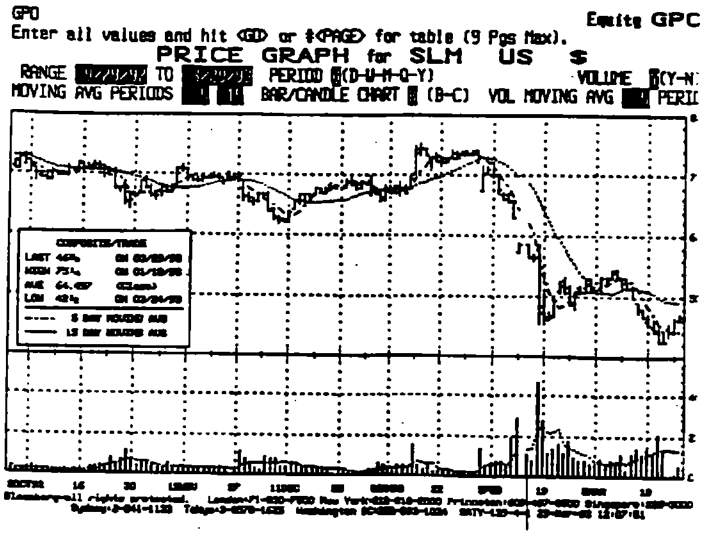
There is no question that comments by the President, Cabinet members, and other senior Administration officials have had significant effects on the price of Sallie Mae stock. The Clinton Administration's proposal to lend directly to students has sent the firm's stock spiraling down from a high of $74 3/8 on January 15 to a low of $42 5/8 on March 24. The day after the President's State of the Union address, Sallie Mae was the most heavily-traded stock on the New York stock exchange, with more than 3.6 million shares changing hands.

In spite of this precipitous drop and the inclusion of the direct lending savings in the President's budget, firms continue to give mixed advice to their clients about Sallie Mae's stock. **Generally, firms are classifying the stock as a "weak hold" to a "sale", with an underlying hope that there may continue to be some role for Sallie Mae in the future.** Some analysts, including First Boston, Solomon Brothers and Mabon Securities, continue to recommend their clients to hold or buy Sallie Mae stock, but **most predict a drastically reduced-role and are presently looking at the stock mostly for its liquidation value.** While there is some dispute about the amount of Sallie Mae's liquidation value, several firms predict that direct lending means the eventual end of Sallie Mae, and that it has long-term value only as it is phased-out of existence.

We should be aware that markets are not thrilled with the direct loan proposal, because they feel that Sallie Mae has performed admirably, building economies of scale and profiting, as other, less efficient loan servicers have failed to keep pace.

It may be hard to predict Sallie Mae's future, but thus far the stock has shown remarkable sensitivity to political events surrounding the direct lending debate, as evidenced by the stock's sharp decline immediately following the State of the Union address. There is general consensus that whatever is proposed, the stock has already hit rock bottom, and markets now are hopeful it may rise if sufficient opposition to direct lending emerges. The large number of outstanding policy questions and a general lack of confidence in the Education Department's administrative abilities have actually bolstered the market somewhat, but the overall prediction is a phase-out.

SALLIE MAE STOCK PERFORMANCE



The price of Sallie Mae's stock dropped off enormously (over $9) just after the President's State of the Union address and the release of the Administration's budget, <u>A Vision Of Change for America's Future</u> (February 17):

State of the Union "...A program of national service to make college loans available to Americans and to challenge them to give something back to their country...to give them the option to pay back their loans...In the future, historians who got their education through the national service loan..." (2/17/93)
<u>**Vision of Change**</u> "The Administration proposes to modify and expand the current direct lending pilot program, with the goal of replacing guaranteed lending now provided under the Federal Family Education Loan Program (FFELP) with direct loans in 1997. Federal capital and schools would replace private capital and banks as loan originators. The direct lending program is to be built up gradually, to permit development and implementation of the administrative systems necessary, while maintaining proper management of the outstanding guaranteed loan portfolio...Estimated savings over five years are $3.2 billion, including $1.3 billion in 1997."* (2/17/93)

Change in stock price:	2/17:	$ 56 5/8
	2/18:	$ 47 1/4 (down $9 3/8)

Rutgers Speech "...we also have to reform the whole system of student loans...The present system is unacceptable, not only for students, but for the taxpayers as well. It's complicated and its expensive. It costs the taxpayers of our country over $4 billion every year to finance the student loan program because of loan defaults and the cost of administering the program. And I believe we can do better." (3/1/93)

Change in stock price:	3/1:	$51
	3/2:	$50 7/8 (down $1/8)

* This estimate has since been revised up to $4.2 billion for the same time period by ED and CBO (see attached memo).

OTHER STATEMENTS

Other senior Administration officials have also made comments about the direct lending proposal. While their statements did not trigger any sharp fluctuation, as that which followed the State of the Union address, they reinforced the impression that direct lending is a definite goal of the Administration:

Secretary Riley The Secretary actually gave the markets a lift somewhat when, according to Shearson Lehman Brothers, he cited the Education Department's "unreliable data, outmoded equipment, and poor staff morale." Subsequently, he has publicly endorsed the Administration's direct lending proposal in general terms.

Secretary Bentsen Secretary Bentsen testified before the Senate Budget Committee shortly after the release of the Administration's budget plan that direct lending "will save us money that now goes to middlemen", becawuse "valuable dollars that could be invested in education are being spent on fees for commercial banks to operate the program".

George Stephanopoulos In a March 2nd press conference, Communications Director Stephanopoulos made the following statements about direct loans: "The President will be reviewing a number of options to simplify student loans and make them serve the interests of students more effectively and efficiently. A system of direct lending by the federal government is one such option; there are others as well. The President will announce his recommendation this spring as part of his overall national service proposal...The OMB document cites full direct lending as a goal, but the speed and extent to which it is attained will be affected by the pilot program....The President continues to explore this merits of full direct lending and other options for improving the student loan system."

Q: "Is the President concerned that the public discussion of this issue has already led to a decline of one-third of the value of Sallie Mae's stock (that's more than $2 billion.)?"

A: "The President is determined to safeguard the integrity and stability of our financial system. His overall budget proposal has already contributed to a major surge of confidence throughout the financial community, and his specific recommendations on student loans will reflect those concerns as well."

SUMMARY OF MARKETS OBSERVATIONS/PREDICTIONS

A survey of reports by various financial consulting firms around the time of the release of the President's budget revealed several potential pitfalls to direct lending -- and reasons some firms are issuing a hopeful recommendation of Sallie Mae stock as a "hold":

Direct lending won't work Many financial analysts simply think that private capital and servicing will prove to be much more efficient than direct lending, and the Administration will soon abandon its direct lending program.

ED lacks the administrative capacity to administer loans directly Many analysts incorrectly assume that direct lending necessarily means that ED will distribute, monitor and service <u>all</u> federally-guaranteed student loans. Given ED's poor record on administrative efficiency, direct loans will not succeed.

A compromise will be worked out Some analysts predict a compromise, probably in the form of a reduced subsidy to banks, will ultimately win out over a full-scale move to direct lending. A recent study by the Congressional Research Service offered reducing the subsidy paid to banks and servicers as an alternative means to achieve cost savings. Lenders have and will continue to cite this study to persuade lawmakers to vote against direct lending.

Direct lending will take many years to implement Sallie Mae's status as a federally-chartered firm might give it a special role to play in the transition. If full direct lending is proposed and passed by Congress, other lenders will want to sell their loans as quickly as possible, probably to Sallie Mae, which could reap profits from the servicing of these loans -- at least until 1997. Even as Sallie Mae decreased its loan portfolio, it could still be a profitable stock; some analysts are projecting a liquidation value as high as $50.00 per share.

Schools won't support direct lending As we found in our outreach meetings, many higher educational institutions in this country don't support direct lending, particularly if they have to assume additional administrative burdens and financial risk for defaulters.

Congress won't support direct lending Congress will want to see the findings of the Demonstration program before it supports full implementation of direct lending. Senator Pell, in particular, is a vocal critic of direct lending. Some analysts predict that the furious anti-direct lending lobbying campaign, begun earlier this month with the Consumer Bankers Association "lobby day", will scare many legislators off.

Administration open to other ways to save money Some analysts say that direct lending is not a high priority of the Administration, and that the student aid reform proposal will be separate from the national service legislation.

Still a role for Sallie Mae About 40 percent of Sallie Mae's assets come from sources not affected by the direct lending proposal. Even if direct lending is adopted, Sallie Mae could still profit, both in the phase-in period, by buying and selling loans from other lenders eager to get out of the market, and after full-scale implementation of direct lending through other sources of income. Sallie Mae's own corporate investment portfolio of cash and securities is $23.25 billion of a total asset pool of $45.32 billion (51%) and other investments, such as the College Facilities Insurance Corporation (Connie Lee). About $9.4 billion of Sallie Mae's total asset pool is in the form of loans made directly to banks, for which guaranteed student loans (held by banks) are the collateral.

By April 19, we should have a strategy to counter each one of these arguments, not only to calm the financial markets, but to be ready with superior background materials to support the legislation. Michele and I are working with Maureen to compile those materials.

OTHER RELEVANT ISSUES

KASSEBAUM AMENDMENT DEFEATED

On Thursday, March 25, the Senate narrowly defeated an amendment to the FY 1994 budget proposed by Senator Nancy Kassebaum (R-KS) that would have preserved the Guaranteed Student Loan program. The narrow margin of the legislative defeat slightly boosted Sallie Mae's stock $1, to $43 5/8.

SALLIE MAE 1992 ANNUAL REPORT

In their message to stockholders in the 1992 annual report, Sallie Mae was surprisingly optimistic about a continued role under direct lending, particular as a buyer of student loans from banks. The report predicts "strong earnings performance and strategic corporate reposititioning to mitigate the risks of a wholesale direct student loan program."

PRIVATIZATION

CEO Larry Hough and Chief Counsel Tim Greene met with Ellen Seidman of the National Economic Council to discuss privatizing Sallie Mae. As expected, Hough raised strong doubts about the savings estimates, and he also urged the Administration to convert Sallie Mae to a completely private entity. Hough's argument is that the Administration wants pension fund and institutional investors, many of whom are Sallie Mae stockholders, to invest in public-private cooperative ventures, but at the same time the Administration is eliminating a prominent and profitable public-private cooperative from the education market. Notes from Seidman's meeting with Hough are attached.

Sallie Mae may be considering a major diversification of its industry, away from a student loan servicer to a quasi-investment bank -- lending money to banks and schools to finance infrastructure investments, for example. Sallie Mae is meeting with Treasury on Monday, April 5 to propose lifting the GSE restrictions.

PROPOSED STRATEGY FOR FINANCIAL MARKETS

Even though the policy debates are far from over concerning the extent of the student aid reform component of the April 20 legislation, it is not too early to think about our communications strategy for the proposal as it relates to financial markets.

We must disseminate the message to the markets that we are proposing a "mixed system" of direct lending which preserves the best, most efficient elements of the private sector, along the lines of the "managed competition" comparison the Deputy Secretary presented to the lenders in our outreach meeting. The political and policy ramifications from allowing Sallie Mae to twist in the wind could be serious. Markets think Sallie Mae does its job relatively well, and if our policies send the stock down further, it will be another sign to the business community of an over-activist Clinton Administration that is punishing a successful company. We should at least indicate that if direct lending is not fully phased in until 1997, Sallie Mae can play a role for the next 7 to 10 years. Sallie Mae enjoys a long-term borrowing rate of 6.4 percent -- just 3/10 of one percent above the Treasury bill rate. Because students pay a post-graduation interest rate of 8 percent, Sallie Mae can still be a profitable stock for several years.

We also need a strategy for the states and secondary markets. If the secondary markets go out of business, state governments will have to cover the costs of the bond issues, which could be a particularly bitter pill to swallow if our proposal demands a much larger role from the states.

ATTACHMENTS

Latest talking points on direct lending Maureen wrote for the Deputy Secretary

Relevant news clips

Dow Jones Report: Sallie Mae closing share price, from December 12, 1992 to March 26, 1993

Ellen Seidman's memo on her meeting with Larry Hough

New CBO-ED direct lending savings estimates

Sallie Mae 1992 Annual Report excerpt on direct lending

SOURCES for this memo include:

Maureen McLaughlin, Acting Assistant Secretary for Postsecondary Education; Dan Morrissey, ED Planning and Evaluation staff; Ellen Seidman, National Economic Council; Jill Ousely, Treasury Department (Domestic Finance); Bob Shireman, Senator Simon's office; Bob Hottenson, Goldman Sachs*; Bruce Steinberg, Merrill Lynch*; Donald Carey, First Boston*; David Tsuneishi & Joan Trumble, OERI.

* spoke off the record

Finance

BUSINESS WEEK MONDAY APRIL 5, 1993 P-74

Commentary/by Dean Foust

STUDENT LOANS AIN'T BROKE. DON'T FIX 'EM

As a candidate, Bill Clinton sold himself as a "New Democrat" willing to forge business-government partnerships that would help him "reinvent" government. But now that he's ensconced in the White House, some of Clinton's proposals seem at odds with his rhetoric. A case in point: his plan to overhaul the federally insured student-loan program.

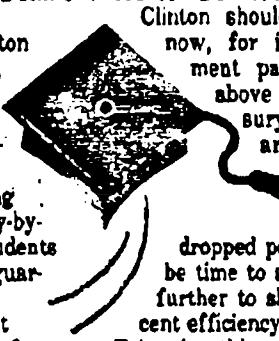
The system currently operates through some 7,800 commercial banks, several dozen state agencies and private companies that back the loans, and a handful of companies such as the Student Loan Marketing Assn. (Sallie Mae), which have created a vibrant secondary market for the $127 billion or so in student loans guaranteed since the program began in 1965. Clinton insists he can shave billions from the program, which he blasts as "wildly expensive," by letting the government make the loans directly. The savings would help finance the Administration's service-for-education program.

STOCK DROP. He can't be serious, can he? The notion that some bureaucrats in the bowels of the Education Dept. could run the program more efficiently than private companies borders on the ludicrous. And replacing private loans with government ones would boost an already bloated budget deficit.

Clinton's eagerness to nationalize the loan program could also make investors wary of public-private ventures the Democrats are considering. In the weeks since he advanced the plan, Sallie Mae's stock has plummeted more than 40%. Who would invest in Sallie Mae-like government-backed ventures that have been proposed to fund small-business and transportation lending? Investors, says a major holder of Sallie Mae stock, "are going to look at new [public-private ventures] pretty skeptically."

Clinton is simply too optimistic in his calculations of the savings. Take the projections of $3.2 billion in savings over five years by switching over to direct government lending. Critics predict the government would just shunt many administrative tasks now done by banks onto colleges, which would likely pass along the additional expenses through higher tuition. And according to a Congressional Research Service study, some $500 million more in annual "savings" actually comes from accounting sleight of hand: The government wouldn't have to create reserves for projected losses from defaults and prepayments. "The estimates of... [billions of dollars in] savings are suspect," says CRS economist Dennis Zimmerman.

Nor is it likely that Washington would be more efficient. Sure, the government would have lower borrowing costs. But the Education Dept. has been criticized for its management of the program, including its slowness to weed out fly-by-night trade schools that bilk students and taxpayers for millions in guaranteed student loans.



What's more, the government would have to invest millions of dollars in proprietary software and other technology to match banks' speed in handling the clerical tasks the program entails. "The government would have a hard time matching the technology that the banks and others have in place," says Roy A. Nicholson, chairman of USA Group, an Indianapolis-based guarantor.

Then there's Sallie Mae, which Congress chartered in 1972. The company purchases, securitizes, and services about a third of all student loans. Chief Executive Lawrence A. Hough has driven its servicing costs down 21% since 1986 (chart) and its profits up 172%. So Sallie Mae's board awarded Hough salary, options, and perks worth $2.1 million in 1991—raising hackles on Capitol Hill. But the hefty compensation was well-deserved, since it was tied to his strong performance.

The current system isn't perfect, of course. But rather than junking it, Clinton should fine-tune it. Right now, for instance, the government pays banks 3.1 points above the three-month Treasury rate while students are in school and haven't begun to repay their loans. That premium has dropped periodically, and it may be time to ask banks to reduce it further to share some of their recent efficiency gains with taxpayers. Trimming this payment by half a point would give banks roughly the same return they make on many other consumer loans—and save taxpayers upwards of $970 million over five years.

When Clinton made his promises about reinventing government, no one thought he meant replacing well-run private businesses with an even more bloated government bureaucracy. The Administration must realize that public-private partnerships will mean profits for those who perform well.

Hough's $2 million salary and Sallie Mae's healthy earnings are a small price to pay for keeping the cost of student lending down. They should be congratulated—not put out of business.

4.

Education Daily ▪ March 26, 1993

P-5

Senate Defeats Kassebaum's 'Direct Loan' Amendment

The Senate yesterday defeated a fiscal 1994 budget resolution amendment that opponents of a direct student loan program viewed as crucial.

By a 51-47 vote, the Senate rejected an amendment by Sen. Nancy Kassebaum, R-Kan., that effectively would have lowered official estimates of the savings engendered by direct loans over five years.

The Congressional Budget Office has estimated a direct loan system--under which the Education Department would provide funds to postsecondary institutions that, in turn, would make loans directly to students--would save about $6 billion over five years in part by eliminating subsidies to the financial institutions now making the loans.

However, the Office of Management and Budget has predicted savings closer to $3.2 billion.

The budget resolution, S. Con. Res. 18--a proposed spending blueprint for Senate authorizing and appropriations panels--would require the Senate Labor and Human Resources Committee to save roughly $6.7 billion over five years.

Kassebaum, ranking GOP member of the Labor and Human Resources Committee, and other direct loan opponents contend that would force the committee to adopt CBO's estimates and implement a direct loan program because there is no other way to achieve such savings.

At least one direct loan opponent said yesterday he was not dismayed by the Kassebaum amendment's defeat.

Consumer Bankers Association Special Counsel John Dean vowed to "tear apart" CBO's estimate when House and Senate negotiators meet to reconcile differences in S. Con. Res. 18 and the House resolution, H. Con. Res. 64, which also included CBO's estimate.

CBO's estimate does not take into account important factors such as the need for an administrative cost allowance for schools, Dean said. Moreover, he said, the closeness of the Senate vote indicates "there is very strong interest among a large number of senators over the unrealistic cost estimate on direct loans."

But direct loan proponents had a predictably different view.

"The momentum is now clearly on the side of those who favor direct student loans," Sens. Paul Simon, D-Ill., and David Durenberger, R-Minn., said in statement released yesterday.
--Mike Sherry

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THE WALL STREET JOURNAL FRIDAY, FEBRUARY 19, 1993 P-8

White House Gives Details Of President's 5-Year Plan

By DAVID WESSEL
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – President Clinton's ambitious spending plan – both proposed increases and proposed decreases – drew intense scrutiny as the White House released more details of his recommendations.

A 145-page summary of the plan, "A Vision of Change for America," shows that Mr. Clinton proposes to spend a grand total of $1.5 trillion in the fiscal year that begins Oct. 1, up 2.6% from the current year. That would include the quick spending increases that Mr. Clinton is proposing to stimulate the economy.

His five-year plan shows total federal outlays rising at an annual rate of 3.3% between this year and fiscal 1997, which begins Oct. 1, 1996, without any adjustment for inflation. Over the same period, revenues are projected to rise at an annual rate of 6.5%.

On the spending side, much of the focus now is on domestic spending other than government-benefit programs – everything from the Federal Bureau of Investigation to nuclear fusion research – because that is where Mr. Clinton is proposing most changes. Of course, the president also is recommending cuts in defense spending, though there aren't many details of his plans yet. And he is proposing some cuts in benefit programs. But other types of domestic spending, known as "investment" in Clinton-speak, would grow. ◆ ◆ ◆

Education

Mr. Clinton's plan to let college students borrow directly from the government is drawing fire from the banking industry, which stands to lose business under the proposal. But supporters say it will be a big money-saver.

The change, which would be phased in by 1997, would let students borrow directly from the government through their colleges, bypassing banks. The savings is estimated at $1.3 billion in administrative and other costs over four years.

Banks and the Student Loan Marketing Association, or Sallie Mae, dispute those estimates, and they're lobbying hard to preserve the program.

The current government-guarantee program pays banks fees to issue the loans. Sallie Mae, a private, government-sponsored corporation, acts as a secondary market by buying the loans from the banks. It says direct lending "will not produce any real savings for taxpayers, schools or students in the actual delivery of loans," but would "shift great risk and costs to states, schools and taxpayers."

Sallie Mae's stock fell earlier this month after a congressionally mandated commission called for overhauling the college-aid system. In composite trading on the New York Stock Exchange yesterday, Sallie Mae plunged $9.375, to $47.25, as 4.7 million shares were traded.

Mr. Clinton also called for spending $6 billion over four years to phase in a new national service program allowing students to pay back college loans through community service.

NEW YORK TIMES, FRIDAY, FEBRUARY 19, 1993 P-16 D

Student Lending Stocks Plunge

By Reuters

President Clinton's plan to phase in direct Government lending to students sent the shares of companies in the business into a virtual free fall yesterday.

Investors feared that the plan – called a "national service loan" by the President in his speech Wednesday night – would ravage the business of the Student Loan Marketing Assocation, known as Sallie Mae, as well as the Student Loan Corporation, which is controlled by Citicorp.

Sallie Mae shares dropped $9.375 each, or 17 percent, to $47.25. It was the most actively traded issue on the New York Stock Exchange, with more than 3.6 million shares changing hands. Student Loan also fell 17 percent to $15.50, down $3.25.

Sallie Mae, a federally chartered company based in Washington, does not originate loans, but it buys and services about a third of all student loans made by banks. Student Loan, based in Rochester, which went public late last year, is the second-largest holder, with 6.5 to 7 percent of the market.

The companies had already been under pressure for weeks on speculation that the Administration would propose a radical change in the guaranteed student loan program.

Under the proposed changes, student loans would be changed to 50 percent direct lending beginning in 1997, with the total shift taking place the following year. The phase-in was an attempt to cushion the effect on the agencies.

While the plan announced on Wednesday seeks only a gradual shift to direct lending, analysts said the companies still faced big political uncertainties.

Comments by Treasury Secretary Lloyd Bentsen that "valuable dollars" could be saved from the fees being paid to commercial banks to operate the program helped to depress the stocks, analysts said.

U.S.NEWS & WORLD REPORT, MARCH 29, 1993

P-62

■ ON MONEY

BY JACK EGAN

Out of love with Sallie Mae

Sallie Mae may seem like a cheap date these days. But investors looking for a more rewarding relationship should be prepared to be patient.

Sallie Mae, as Wall Street and Washington nicknamed the Student Loan Marketing Association, was once the darling of pension and mutual funds and Wall Street analysts. Before their recent tumble, shares in the leading intermediary in the market for college credit had appreciated 800 percent since first trading publicly in mid-1983. Now many big-buck investors have been dumping them. Shares plunged to $45.50 recently, down almost 40 percent from a 1993 high of $75, and by last week had edged up only to around $47. The hybrid public-private enterprise is backed by government guarantees but earns a profit ($394 million last year) and pays dividends to shareholders.

ILLUSTRATION BY MARC ROSENTHAL FOR USN&WR

Behind Sallie Mae's sudden reversal of fortune is President Bill Clinton's planned overhaul of the multibillion-dollar student-loan program. As part of the proposal, the federal Treasury would make such loans directly and the colleges would service them. By eliminating the profits in the program that now go to Sallie Mae and the banks that make the loans, the Clinton administration claims it will save over $1 billion a year.

Beyond building the presumed but iffy cost savings into its budget, the new administration seemingly wants to prove that a reinvented federal government can sometimes do a better job than the private or, in this case, the quasi-private sector. As a Washington-based enterprise, Sallie Mae's sin may be its entrepreneurialism. Reformers resent Sallie Mae's turning a solid profit and, until recently, having a top-performing stock. "This campaign is being driven in part by a populist, bash-the-banks appeal," says Larry Hough, Sallie Mae's chief executive. Not surprisingly, the $2.1 million he earned in salary and benefits in 1991 is itself a key exhibit in the case being made against the current student loan program.

'A handful of analysts continue to recommend the shares.'

Even with Sallie Mae's future in jeopardy, a handful of analysts continue to recommend the stock – especially at its new low price – but only to stalwart investors. "This is not the widows and orphans stock it used to be," warns Gareth Plank, who follows Sallie Mae for Mabon Securities, a New York brokerage. He doubts that Sallie Mae will vanish in the end, though its profits could wind up being crimped a bit. Plank thinks the shares could be worth as much as $80 in the next couple of years. And even if Sallie Mae gets phased out, he estimates its current book value at $50 a share. "How often do investors get to buy a stock where the appreciation potential is rather substantial and on a liquidation basis the downside risk is rather low?" he asks rhetorically.

Buffett rebuff. Published reports that have linked Warren Buffett, the renowned "value" investor, to a position in Sallie Mae were apparently wrong, unfortunately for those who like to piggyback on Buffett's legendary but far from infallible acumen. "I've never really looked at Sallie Mae," he says. But that shouldn't deter investors from considering the stock on its merits. The ultimate case for Sallie Mae stock assumes the organization will survive because the Clinton plan will not produce the projected savings.

In the first place, setting up a whole new government bureaucracy is bound to be costly. Moreover, a recent report from the Congressional Research Service questioned whether costs might not rise more than expected because the Treasury would have to increase its borrowing by $10 billion to $15 billion a year – and at a time when stemming the growth of government borrowing supposedly is the major priority.

Doing away with Sallie Mae anytime soon is literally impossible: vast amounts of loans continue to need servicing, and new loans need to be extended. What's most likely is a pilot program in which the federal government and Sallie Mae will run on parallel tracks for some time, providing an opportunity for comparison. Key members of Congress also favor a deliberate start-up. "That will give us an opportunity to understand the real administrative problems as they develop and correct them," says Democratic Rep. Rob Andrews of New Jersey, a strong proponent of a direct lending program. Sallie Mae's Hough predicts that in such a matchup, "we will emerge as the winner in terms of performance and cost-effectiveness."

That assumes the results will be judged on their merits. Most worrisome for investors is the federal government's demonstrated reluctance to call it quits on a program, even if it isn't working. That still could spell curtains for Sallie Mae, even if the company shows it's doing a better and more cost-effective job. To quote Congressman Andrews: "If the savings don't materialize, we'll cut other programs or fix it." ■

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 P-3F

Clinton Proposal Hits Sallie Mae Hard

Plans to Revamp Student Loan Programs Send Stock Price Plunging

By Jerry Knight
Washington Post Staff Writer

President Clinton's proposal to revamp federal student loan programs threatens to destroy the extremely profitable business of one of Washington's most successful companies, the Student Loan Marketing Association, known as Sallie Mae.

After the president discussed his new student loan plan in Wednesday night's State of the Union Address, panicky investors dumped Sallie Mae stock yesterday, placing so many orders to sell that the New York Stock Exchange had to halt trading until buyers could be found to take the shares.

By the end of the day, Sallie Mae was the most heavily traded issue and lost more value than any other stock, falling \$9.37½ for the day to \$47.25.

The stock was selling for almost \$75 a share until a month ago, when Clinton administration officials floated the idea of replacing the government-guaranteed student loan (GSL) program with direct federal loans.

Sallie Mae is the nation's biggest source of money for student loans, supplying almost a quarter of all GSL funds last year. It provides the cash to banks that make the loans and then collects payments on the loans after the student borrowers graduate.

But the president has said it would be cheaper for the government to lend the money directly to students, cutting Sallie Mae and the banks out of the lucrative business. The Office of Management and Budget says the government could save as much as \$1.8 billion a year if colleges handled loan applications, the government put up the money and the Internal Revenue Service collected the loan payments along with income taxes.

Sallie Mae responds that such a plan would require creating a new government bureaucracy to handle loan programs that are run efficiently by private enterprise. "Direct lending will not produce any real savings for taxpayers, schools or students in the actual delivery of loans," said a statement issued yesterday by Sallie Mae.

Stunned by the stock market's assumption that Congress will approve the president's plan, Sallie Mae officials are trying to reverse the political momentum and have signed up lobbyists J.D. Williams and Frank Mankiewicz to aid their cause.

Congress created Sallie Mae in 1972 to raise funds for student loans. A decade later, it became a private corporation by selling stock to investors. One-third of Sallie Mae's board is appointed by the president.

Sallie Mae is based in Georgetown and has about 1,000 employees in this area, and another 3,500 around the country. Last year, the agency earned \$393.9 million, up almost 15 percent from the previous year.

Sallie Mae's leading critic in Congress, Sen. Paul Simon (D-Ill.), said Clinton's plan "will benefit millions of students, our schools and the taxpayers" if it can survive "intense special-interest lobbying by those who profit under the present system. . . . Those special interests—especially Sallie Mae—have been lobbying hard since the election to kill this idea."

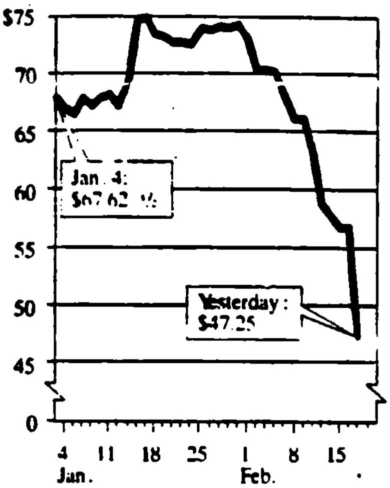
Treasury Secretary Lloyd Bentsen told the Senate Budget Committee that the president's plan "will save us money that now goes to middlemen" because "valuable dollars that could be invested in education are being spent on fees for commercial banks to operate the program."

Even critics of Sallie Mae, however, question whether simply switching from private to government lending is the best way to improve the student loan program. "What's needed is a program that provides cheaper loans and also allows the government to tap into the considerable financial expertise of institutions like Sallie Mae," said Washington attorney Thomas Stanton, author of a book on Sallie Mae and similar government-chartered programs.

SALLIE MAE IN PROFILE

- **NAME:** Student Loan Marketing Association
- **HEADQUARTERS:** Washington, D.C.
- **EMPLOYEES:** 4,387
- **BUSINESS:** Sallie Mae is a government-sponsored enterprise founded to purchase and collect student loans made under federally sponsored student loan programs.
- **LOANS OUTSTANDING:** \$24 billion at end of 1992.
- **1992 REVENUE:** \$2.8 billion
- **1992 PROFIT:** \$393.9 million

RECENT STOCK ACTIVITY
DAILY CLOSES



SOURCE: Bloomberg Business News, Sallie Mae

THE WASHINGTON POST

DOW JONES HISTORICAL
STOCK QUOTE REPORTER SERVICE

STOCK SLM

DATE	HIGH	LOW	CLOSE	VOL(100/S)
02/12/92	71 3/4	69 1/2	71 3/4	1819
02/13/92	71 3/4	70 1/8	70 3/8	2072
02/14/92	70 3/8	68	68 1/4	1670
02/18/92	68 3/8	67 1/4	67 1/4	1213
02/19/92	67 1/2	64 1/4	65	2287
02/20/92	65 1/2	61 1/2	62	10692
02/21/92	67	63 5/8	63 5/8	6921
02/24/92	64 1/4	63 5/8	64 1/8	2971
02/25/92	65 3/8	63 7/8	65 1/8	2553
02/26/92	68 1/8	64	67 3/4	4495
02/27/92	68 1/2	67 1/4	67 1/4	2422
02/28/92	67 3/8	64 1/2	65 7/8	1856
03/02/92	66	65 1/8	66	2543
03/03/92	65 3/4	62 1/2	63 1/4	5700
03/04/92	64	63 3/8	63 1/2	5215
03/05/92	63 1/8	62	62 1/4	2805
03/06/92	64	62	62 1/2	3186
03/09/92	64 5/8	62 1/4	64 1/2	1419
03/10/92	64 5/8	64 1/8	64 1/4	1392
03/11/92	64	62 5/8	63	1808
03/12/92	63 1/4	61 5/8	62 1/2	2159
03/13/92	64	61 5/8	63 1/2	1620
03/16/92	64 1/4	62 3/4	64 1/8	1709
03/17/92	64 7/8	64	64	2774
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03/19/92	65 1/4	64 3/4	64 7/8	2914
03/20/92	65 1/2	64 1/2	64 7/8	1558
03/23/92	65 1/4	64 3/8	65 1/4	2631
03/24/92	65 3/4	64	64	3970
03/25/92	65	63	64	2041
03/26/92	63 3/4	60 1/2	62 1/4	5023
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04/15/92	70	68	68 1/4	2122

04/16/92	68 3/4	66 1/4	66 1/4	2321
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04/23/92	63 3/8	61 3/4	62	1565
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04/30/92	64 1/4	63	63 1/2	3064
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06/02/92	65	64	64 1/4	1155
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06/26/92	65	64	64 1/4	995
06/29/92	66 1/2	64 3/4	66 1/8	2938
06/30/92	69 1/4	66 5/8	68 1/2	5145
07/01/92	69	67 3/4	68 1/8	4456
07/02/92	69 1/8	68 1/8	68 1/4	3231

07/06/92	70 3/8	67 7/8	70	2452
07/07/92	71 1/2	69 1/4	70 1/8	5333
07/08/92	70	69 1/4	69 3/4	2221
07/09/92	70 3/8	68 3/4	70 3/8	2367
07/10/92	72 1/2	69 3/4	72 3/8	2454
07/13/92	71 3/4	70 1/4	70 1/4	2612
07/14/92	70 1/2	69 1/2	70 1/4	2267
07/15/92	70 7/8	70 1/4	70 3/4	3133
07/16/92	70 3/4	70 1/4	70 1/2	2074
07/17/92	70 5/8	69 3/8	69 1/2	2704
07/20/92	68 3/4	67	67	2312
07/21/92	67 1/4	64 1/4	64 3/8	5270
07/22/92	64 7/8	63 1/	64 3/4	1962
07/23/92	66 1/2	64 7/8	66 3/8	3294
07/24/92	66	65 1/4	65 7/8	1193
07/27/92	65 7/8	63 1/2	64	2254
07/28/92	65 1/8	64	65 1/8	5361
07/29/92	67 1/4	65 1/2	66 3/4	3861
07/30/92	67 3/4	66 3/8	67 3/4	1961
07/31/92	69	67 1/2	69	1474
08/03/92	68 3/4	67 1/2	67 7/8	922
08/04/92	68 5/8	67 1/2	68 5/8	1824
08/05/92	68 7/8	68 1/4	68 7/8	1056
08/06/92	69	67 3/4	68	1155
08/07/92	68 1/2	66 1/2	66 5/8	1230
08/10/92	67	65 3/4	66 3/4	973
08/11/92	68	66 3/4	67 5/8	1292
08/12/92	69 1/4	66 7/8	69 1/8	1665
08/13/92	69 1/4	67 7/8	68 1/8	2659
08/14/92	68 7/8	68 1/8	68 5/8	1425
8/17/92	70 1/4	68 7/8	70 1/8	3197
08/18/92	72 5/8	69 7/8	72 1/2	6013
08/19/92	72 1/2	71 3/4	72 1/4	2844
08/20/92	72 1/4	71 5/8	72	2329
08/21/92	72 1/2	69 3/4	70 3/8	2239
08/24/92	69 7/8	68 1/2	69 7/8	1614
08/25/92	70 3/8	69 1/8	70 1/4	2359
08/26/92	72 1/4	70 1/8	72 1/4	179
08/27/92	74 1/4	72 1/4	73 7/8	5896
08/28/92	74 1/4	73 1/2	73 7/8	2664
08/31/92	74 1/4	73 5/8	73 5/8	2094
09/01/92	73 5/8	72 1/8	72 3/4	3459
09/02/92	72 5/8	72 1/4	72 3/8	864
09/03/92	72 3/4	72 3/8	72 5/8	1689
09/04/92	72 5/8	72 1/4	72 1/4	740
09/08/92	72 3/4	71 3/8	72 3/4	1322
09/09/92	73 1/2	72 1/8	73	2757
09/10/92	74 1/4	72 3/4	74	2768
09/11/92	74 1/8	73	74	2094
09/14/92	76	74	75 7/8	4329
09/15/92	75 5/8	74	74 1/2	2706
09/16/92	74	73	73 5/8	2687
09/17/92	74 1/2	73 1/4	73 1/2	1302
09/18/92	73 5/8	72 7/8	73 1/4	1626

09/21/92	73 3/4	72 3/4	73	2530
09/22/92	73	71 7/8	72	3165
09/23/92	73 1/2	72 3/8	73 3/8	4308
09/24/92	74	72 1/2	73 3/8	2213
09/25/92	73 1/4	70 1/4	70 3/8	2670
09/28/92	71 7/8	70	71 1/2	1564
09/29/92	71 1/2	70 3/4	70 3/4	2240
09/30/92	72 5/8	70 5/8	72 5/8	1419
10/01/92	73 3/8	71 3/4	72	2375
10/02/92	72 1/8	70 3/4	71 1/4	2157
10/05/92	71	68 3/4	70	3241
10/06/92	70	69 1/4	69 1/4	1010
10/07/92	69 3/4	68 7/8	69	1129
10/08/92	70 3/4	69	70 1/2	2108
10/09/92	70 1/4	69 3/4	69 3/4	1270
10/12/92	70 1/4	69 3/4	70	689
10/13/92	71 3/8	69 7/8	71	2117
10/14/92	71	70 1/2	70 7/8	1096
10/15/92	71 7/8	70 1/8	71 3/4	2090
10/16/92	71 1/2	70 1/2	71 1/8	2736
10/19/92	71 5/8	71	71 1/4	1674
10/20/92	72	71 1/4	71 1/2	3336
10/21/92	71 7/8	70 3/4	71 3/8	3564
10/22/92	71 3/8	70 5/8	70 3/4	4377
10/23/92	71 1/4	69 7/8	69 7/8	4108
10/26/92	70 7/8	67 1/2	67 5/8	8047
10/27/92	68	67	67 3/4	4596
10/28/92	68 3/4	64 3/4	65 3/8	6872
10/29/92	66 7/8	64 1/4	65 1/2	11049
10/30/92	66 7/8	66	66 1/8	7212
11/02/92	68 7/8	66 3/4	68 3/4	3862
11/03/92	69 1/2	67 1/2	67 3/4	4719
11/04/92	68 1/8	66	66 3/8	4636
11/05/92	66 5/8	65 1/2	66 1/8	4128
11/06/92	68	66 1/4	67 3/4	2838
11/09/92	68 1/4	67	67 1/8	2746
11/10/92	68 1/8	66 7/8	68 1/8	5356
11/11/92	71 1/8	68 1/8	71	3620
11/12/92	71 1/2	70 1/2	70 7/8	1962
11/13/92	71	69 3/4	69 7/8	2428
11/16/92	69 3/4	68 7/8	69 1/8	2590
11/17/92	69 1/2	68 5/8	68 7/8	3044
11/18/92	69 1/4	68 5/8	69 1/4	2434
11/19/92	69 7/8	69 1/4	69 7/8	2181
11/20/92	70 1/2	69 3/8	69 7/8	3595
11/23/92	69 7/8	69 3/8	69 3/8	1915
11/24/92	69 3/8	68 3/8	68 7/8	3566
11/25/92	70 1/2	69 1/4	69 5/8	1671
11/27/92	70	69 5/8	69 3/4	1082
11/30/92	68 1/8	65 1/2	66 1/4	11345
12/01/92	67	65 3/8	65 3/8	7925
12/02/92	66	64 3/4	65 5/8	5115
12/03/92	67	65 1/4	66 3/4	2904
12/04/92	67	66 3/8	66 3/8	2046

12/07/92	67 1/4	64	64	8640
12/08/92	64 1/2	62 1/2	62 3/4	7734
12/09/92	63	61 7/8	62 1/4	7684
12/10/92	62 1/2	62	62	4018
12/11/92	63 7/8	62 1/8	63 3/4	4386
12/14/92	65 3/4	64 1/4	65 1/2	5255
12/15/92	66 3/4	65 1/8	6? 3/4	4933
12/16/92	66 7/8	65 1/4	66 5/8	3649
12/17/92	66 3/4	66	66 3/8	2648
12/18/92	68	66 3/4	67 7/8	3151
12/21/92	67 3/4	67	67 1/8	2779
12/22/92	68	66 3/4	67 3/4	3645
12/23/92	68 5/8	67 5/8	67 7/8	3336
12/24/92	68 3/8	67 3/4	68 1/4	875
12/28/92	69 1/4	68 1/4	68 7/8	2112
12/29/92	70	68 3/4	69	2243
12/30/92	68 3/4	67 1/2	67 5/8	1458
12/31/92	69	67 3/4	68 7/8	1005

DOW JONES HISTORICAL
STOCK QUOTE REPORTER SERVICE

STOCK SLM

DATE	HIGH	LOW	CLOSE	VOL(100/S)
01/04/93	69 3/4	66 1/2	67 5/8	2612
01/05/93	67 7/8	66 5/8	66 7/8	2560
01/06/93	67 3/8	65 5/8	66 1/4	6026
01/07/93	68 1/2	65 3/4	67 5/8	5110
01/08/93	68 1/8	67	67	3444
01/11/93	68 1/8	67 1/4	67 3/4	1957
01/12/93	68 7/8	66 1/2	68	4723
01/13/93	68 1/2	66 3/4	67	5037
01/14/93	69 7/8	67 3/4	69 3/8	4242
01/15/93	75	70 1/8	74 3/8	15125
01/18/93	75 1/4	73 1/4	74 1/2	5030
01/19/93	74 1/2	73 1/4	73 1/4	3042
01/20/93	73	71	73	4924
01/21/93	73 3/4	72 1/4	72 3/8	2217
01/22/93	72 3/4	71 3/4	72 1/8	2146
01/25/93	72 7/8	72 1/8	72 1/4	2465
01/26/93	74 1/4	73	73 3/4	2510
01/27/93	74	72 3/4	73 1/2	2225
01/28/93	74	73 1/2	73 7/8	1062
01/29/93	74	73 1/2	73 3/4	845
02/01/93	74 1/8	73 5/8	74	2173
02/02/93	74 1/8	72	72 3/4	2428
02/03/93	71 1/2	67 1/2	70 1/8	13521
02/04/93	71 1/2	70 1/2	71 1/8	4680
02/05/93	72 1/4	69 3/4	70	4077
02/08/93	70	67	67 3/4	6939
02/09/93	67 1/4	66	66	5479
02/10/93	67 1/8	65 5/8	65 7/8	4937
02/11/93	65 7/8	62 3/4	63 1/8	17982
02/12/93	58 3/4	57 1/8	58 5/8	28899
02/16/93	58 1/2	56 5/8	56 5/8	10812
02/17/93	57	56	56 5/8	7675
02/18/93	58 1/2	45 1/2	47 1/4	47327
02/19/93	50 1/2	46	46 3/8	27697
02/22/93	47 1/2	46 1/8	46 1/2	11507
02/23/93	50 1/4	46 5/8	49 3/8	13409
02/24/93	52 1/2	50 3/8	51 7/8	16091
02/25/93	53 1/8	50 1/2	50 5/8	11086
02/26/93	51 7/8	48 5/8	49	17511

DOW JONES HISTORICAL QUOTES

STOCK SLM Sallie Mae

DATE	HIGH	LOW	CLOSE	VOL(100/S)
03/11/93	54 5/8	53 3/8	53 1/2	6856
03/12/93	53 3/8	51 1/2	52 1/4	10688
03/15/93	52 5/8	51 1/2	51 5/8	2982
03/16/93	51 3/4	49 3/4	49 3/4	10529
03/17/93	49 1/8	47 1/2	48 1/8	14235
03/18/93	48	46 3/4	46 7/8	10629
03/19/93	46 3/8	45 1/4	45 1/4	13475
03/22/93	46 1/4	44 1/2	44 5/8	10218
03/23/93	44 7/8	42 1/2	42 5/8	20710
03/24/93	44 1/8	42 1/2	42 5/8	13507
03/25/93	45 5/8	43 1/2	43 5/8	15558
03/26/93	46 3/8	44 1/4	46 3/8	13148

DATE	HIGH	LOW	CLOSE	VOL(100/S)
02/23/93	50 1/4	46 5/8	49 3/8	13409
02/24/93	52 1/2	50 3/8	51 7/8	16091
02/25/93	53 1/8	50 1/2	50 5/8	11086
02/26/93	51 7/8	48 5/8	49	17511
03/01/93	51	48	51	9089
03/02/93	51 3/4	50 3/8	50 7/8	7867
03/03/93	52 3/4	51	52 1/8	8051
03/04/93	52 7/8	51	51 1/2	5998
03/05/93	51 3/8	50 3/8	50 3/4	6219
03/08/93	53 1/2	50 3/4	53 3/8	8346
03/09/93	53 3/8	52	52 7/8	5145
03/10/93	54 3/8	53 1/8	54 1/4	7855

March 28, 1993

CURRENT ESTIMATES FOR STUDENT LOAN POLICY

Administration and CBO estimates for the savings for Direct Lending and the student loan State Default Fee in the February 17, 1993 document, "A Vision for Change in America", were based on preliminary concepts and designs. Since then, substantial work has been done to refine policy. This has resulted in a number of revised design parameters that, in turn, result in new cost estimates. The Administration and CBO agree on the general range of cost estimates outlined below.

Direct Lending

The general policy announced on February 17th has not changed: The Administration proposes to modify and expand current law (which authorizes only a pilot direct lending program), with the goal of full implementation of direct lending during FY 1997. Direct lending will be phased in during the intervening period.

- Changes to the CBO estimate of the February 17th policy are the result of specific design changes:

Summary:	1994-1998 outlay savings from baseline ($ in billions)
Original CBO estimate	- 6.1
Modified phase-in path yielding reduced subsidy savings	+ .9
Additional administrative costs (repayment mechanism for income contingency; computer systems; guaranteed lending transition costs)	+ .2
Additional costs for alternative loan origination for schools that do not have sufficient capacity to originate	+ .2
Return some savings to students at full implementation (reduced interest rate)..	+ .6
Revised CBO 5 year savings estimate ...	- 4.2

- Components of the new program design (savings from baseline):

Subsidy savings from phase in (new path) of direct lending	- 7.4
Administrative costs of building up direct lending and income contingent repayment mechanisms	+ 1.7
Administrative costs of phasing down the guaranteed loan programs	+ .9
Reduced interest rate to students at full implementation (on the order of one half percentage point)	+ .6
Revised CBO 5 year savings estimate ...	- 4.2

State default fee

The general policy in the February 17th document for the State default fee has not changed: to provide an incentive to States to improve licensing procedures and oversight of schools in the loan programs. States will be required to share the cost of excess defaults in schools in the State (State costs could be recovered from schools). The goal of the policy is to encourage States to take actions that reduce the incidence of default. It is consistent with Congress' passage in 1992 of a stronger State role in ensuring program integrity.

The proposal is coupled with a discretionary appropriation request to support enhancement of State capacity to oversee high default schools as provided in the 1992 HEA amendments.

The CBO estimate was based on a preliminary implementation design: setting the State share of default costs at half the excess over 20 percent in each school, beginning in FY 1994.

The policy the Administration now will propose retains the same goal. However, it recognizes that States need time to revise systems and procedures and that certain schools need time to adjust to the policy.

The new CBO estimate is based on the modified policy of:

o delaying start up of the default fee policy until FY 1995; and

o phasing in the policy over the succeeding four years.

	1994-1998 outlay savings from baseline ($ in billions)
Original CBO estimate	- .6
Change for delayed implementation and slower phase-in	+ .3
Revised CBO 5 year savings estimate......	- .3

REVISED 5 YEAR SAVINGS ESTIMATES:

	1994	1995	1996	1997	1998	1994-1998
Dir. lns.	116	114	- 406	- 1,667	- 2,318	- 4,195
St. fee	0	- 24	- 57	- 106	- 118	- 306
Total	116	90	- 463	- 1,773	- 2,436	- 4,501

March 17, 1993

MEMORANDUM FOR BO CUTTER
GENE SPERLING

FROM: Ellen Seidman

SUBJECT: Visit from Larry Hough and Tim Greene of Sallie Mae

On March 15, Larry Hough, President and CEO of Sallie Mae, and Tim Greene, General Counsel, visited me to discuss the direct student loan program and Sallie Mae's conversion to a completely private corporation.

On the subject of direct student lending, Hough was adamant that the savings in the Administration's plan, and more particularly the $6-7 billion savings that he says CBO has calculated for the budget resolutions, will not be realized because:

- o The Education Department, he asserts, is simply incapable of running the direct loan program, including contracting out for services, particularly at the same time it is running the remnants of the guarantee program.

- o There will be insufficient capacity in the industry both to originate and service the loans, as commercial banks will pull out (since they see no future in the program) before new originators (including colleges) and servicers are on line. This will both increase the price the Education Department must pay for origination and servicing and reduce its quality. Hough says that approximately 20% of the loans are serviced by holders rather than any secondary market agency, and that originating Perkins loans is far easier for colleges than originating the kind of loans involved here, so that Perkins capacity cannot be assumed to be totally available for the new program.

- o Hough asserts that some of the administrative cost savings are budget gimmicks, as these are real expenses that appear nowhere in the budget for a direct loan program, i.e., they are counted neither in the subsidy nor in any S&E account.

- o CBO assumes funding the program with 10-year Treasuries, rather than with maturity-matched funding. While this may accurately reflect what the government will in fact do, it means that savings are exaggerated because of the substantial drops that have occurred in medium term interest rates.

Hough also maintained that if income contingent repayment is a major goal of the change, it can be accomplished more quickly under the current program. He said that Sallie Mae's upcoming conversion of its loans from coupon-based repayment to billing means that for Sallie Mae, at least, this change would be relatively easy to administer (although it does require the IRS to verify a borrower's statement of income).

I listened to Hough's arguments, and pointed out that the President's February 17 program encompassed direct lending.

On the subject of Sallie Mae's conversion to a private entity, Hough urged quick action, saying the cloud over the stock was causing serious problems. He pointed out that many pension funds and other institutional investors who the Administration would like to invest in other government-related enterprises (like infrastructure) are big Sallie Mae stockholders. He emphasized the following points:

- o Sallie Mae wants a total break with the government, encompassing loss of all GSE privileges, including the securities laws exemptions and access to FedWire.

- o They envision creation of two classes of debt, with debt issued before the start of privatization retaining its current status and privileges, but new debt totally unguaranteed and without any of the collateral GSE privileges. The assumption is that the GSE-status debt, being relatively short-term, will roll off quickly, after which the company would be totally private.

- o At the start of the privatization process, Sallie Mae would want relief from current charter restrictions, but the new operations (and indeed, the continuation of old operations to the extent new debt was required to fund them) would be financed only with non-GSE funds. (The assumption here is that the company's equity is, and always has been, non-guaranteed.) Hough and Greene admit this will take some structuring, but say they have given it a good deal of thought over the last several years.

- o Hough believes that even without GSE status Sallie Mae could borrow at close to its current rates, and in any event at a level that made it profitable to buy in much of the outstanding guaranteed debt as the direct loan program kicks in, which he said would be a major part of the corporation's strategy.

I explained to Hough that the Treasury Department would be pursuing this issue in the first instance. Hough has since called Debbie Danker to start the process going.

cc: Bill Galston
Deputy Secretary Kunin, Department of Education
Maureen McLaughlin, Department of Education
Frank Newman, Treasury
Debbie Danker, Treasury

Federal Income Taxes

Sallie Mae maintains a portfolio of tax-advantaged assets principally to support education-related financing activities. That portfolio was primarily responsible for the decrease in the effective tax rate from the statutory rate of 34 percent to 30 percent, 27 percent, and 25 percent in 1992, 1991, and 1990, respectively. Sallie Mae is exempt from all state, local and District of Columbia taxes except for real property taxes.

In the fourth quarter of 1992, Sallie Mae adopted Statement of Financial Accounting Standards No. 109, and now accounts for income taxes using the liability method. Adoption of this standard resulted in additional federal income tax expense of approximately $5 million. (See Note 14 to the consolidated financial statements).

Preferred Stock

Preferred stock dividends are cumulative and payable quarterly at 4.50 percentage points below the highest yield of certain long-term and short-term United States Treasury obligations. The dividend rate for any dividend period will not be less than 5 percent per annum nor greater than 14 percent per annum. For the years ended December 31, 1992, 1991, and 1990 the preferred stock dividend rate was 5.00 percent and reduced net income attributable to common stock by $10.7 million.

Statutory Capital Adequacy Ratio

The Higher Education Amendments of 1992 require that, if Sallie Mae's credit rating falls below one of the two highest full rating categories of a nationally recognized statistical rating organization, Sallie Mae must maintain a statutory capital adequacy ratio (the ratio of stockholders' equity to balance sheet assets plus 50% of certain off-balance sheet items) of at least 2% or be subject to certain "safety and soundness" regulations. At December 31, 1992 Sallie Mae's statutory capital adequacy ratio was 2.53%.

Direct Loan Program

The Clinton Administration's economic proposal includes a recommendation to expand the direct lending demonstration program with the goal of replacing FFELP in 1997. Under the proposal the federal government would make student loans directly, rather than through bank and other financial intermediaries. If Congress were to adopt this portion of the Administration's proposal Sallie Mae could experience material adverse effects on its business given the limitations on its ability to diversify its products and services under its existing federal charter. It is likely, however, that other holders of FFELP loans, principally banks, would sell their holdings if the future pipeline of business were foreclosed so that Sallie Mae's student loan purchase growth in the near term could accelerate. Management believes that should a phase-out of the FFELP occur, it would provide time and opportunity for continued strong earnings performance and strategic corporate repositioning to mitigate the risks of a wholesale direct student loan program.

FROM 1992 ANNUAL REPORT