FOIA Number: 2017-1074-F

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THE WHITE HOUSE

WASHINGTON

THE PRESIDENT HAS SEEN
5-26-97

May 22, 1997

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MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING
ELLEN SEIDMAN

SUBJECT: Sallie Mae shareholders' battle - Washington Post article of May 16, 1997

You wanted to know what the attached May 16 Washington Post article concerning the ongoing battle among Sallie Mae's shareholders about competing privatization proposals means. The short answer is very little for the government, and probably in the end not much for the future of a privatized Sallie Mae.

BACKGROUND: In the early 1990s, Sallie Mae had a major internal management dispute between Larry Hough, Chairman and CEO, and Al Lord, then COO and CFO, which resulted in Lord's leaving the company. Much of the dispute centered on whether and how the company should privatize. Lord essentially took the position that the government franchise was worth the limitations on the company's business purposes; Hough wanted to privatize and expand. The Administration's push for direct student lending ended whatever doubts Hough and his management team might have had about privatization. They began to fight for legislation privatizing the company. The Administration supported privatization, but battled with Sallie Mae over the terms of the transition[1] and over whether Sallie Mae would cease its campaign against the direct lending program.

In 1995, Lord formed the Committee to Restore Value at Sallie Mae (CRV) and waged a proxy fight for control of the company. The CRV nominees, of whom Lord was one, won eight of the fourteen shareholder-elected seats on the Board. Hough has retained his positions, however, with the support of the seven Presidentially-appointed directors.

In September 1996, Congress passed legislation establishing a process for privatizing Sallie Mae. The company's shareholders have until the end of March 1998 to vote whether to privatize the company. If they vote to privatize, the company would be restructured into a completely private holding company with a totally shareholder-elected Board of Directors which could, through subsidiaries, engage in any business activity. Current Sallie Mae would be a subsidiary of the holding company (with a board including presidential appointees). Its business would be limited

[1] There were disagreements concerning whether there should be a firm date for liquidation if the shareholders rejected privatization, whether there should be an exit fee (no, but the DC Control Board will, in the likely event of privatization, receive stock warrants that at Sallie Mae's current market price should be worth over $20 million), and the terms of regulation of the liquidating GSE.

to purchasing, holding and selling guaranteed student loans and the company would be required to wind down and dissolve by September 30, 2008.[2] If the shareholders vote against privatization, Sallie Mae must liquidate by July 1, 2013.

In January 1997, Sallie Mae's Board of Directors approved and presented to the shareholders a plan of reorganization and a slate of candidates -- led by Larry Hough -- for the new holding company's board of directors. In April, the CRV put forth a competing slate of directors. Sallie Mae's seven Presidentially-appointed directors have supported the Hough slate, but the CRV members of Sallie Mae's board are supporting Lord.

Although Lord initially opposed privatization, CRV now supports it, and thus it is highly likely privatization will proceed in some form. The major difference -- other than personality -- among the two groups now appears to be the extent to which a privatized Sallie Mae will become a loan originator, competing with the banks from whom the company has traditionally bought loans. Hough maintains that (i) it would take Sallie Mae years to get into the origination business and (ii) in the interim the profitable secondary market and servicing businesses would die because Sallie Mae would be competing with its suppliers. (One of the reasons Sallie Mae is ripe for privatization is that there are alternative secondary market purchasers and loan servicers with whom originators can do business.) Lord asserts that much of the profitability of the business lies in origination and there's no good reason to concede that part of the profit to the banks. Although Lord has made casual remarks suggesting a new Sallie might become a direct loan servicer, it's fair to say neither side favors the direct loan program.

For the last several months, Lord and Hough have each been trying to get a majority of the shareholders to vote for their slate of directors.[3] Most of Sallie Mae's shares are held by institutional investors. As of the end of last week, each side had garnered over 20 million shares, but it was becoming clear that neither side was likely to get the approximately 26 million shares needed to get its slate elected. Both groups are still trying to get more votes. They are also talking to each other in an attempt to find a unifying compromise, which is likely to revolve around the divison of seats on the new holding company board between the rival factions.

The Administration supported privatization because we believed there was no further need for a government-backed secondary market for guaranteed student loans, both because of the direct loan program and because private-market competitors had developed. We think it is highly likely that Sallie Mae will indeed move to privatize in an orderly manner, rather than limp along waiting for liquidation. The Presidentially-appointed board members have -- on their own and without any direction from anyone in the government -- positioned the company so the shareholders will decide the company's future. We see no reason to intervene.

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[2] This date was chosen to be outside the 10-year Senate budget window. Sallie Mae must pay the government an "offset fee" on purchased student loans.

[3] The battle has been punctuated by lawsuits over the date of the annual meeting, the meaning of any vote in favor of Lord's slate, and by both defections from Hough and public expressions of support for him by senior Sallie Mae officials.

THE PRESIDENT HAS SEEN
5-16-97

Sallie Mae Managers' Plan Rejected

Two Groups Deadlocked Over Firm's Future as Private Company

By Albert B. Crenshaw
Washington Post Staff Writer

Management of the Student Loan Marketing Association failed yesterday to win a majority of shareholder votes for its plan to convert the company to a fully private corporation. That shortfall leaves management and an opposition stockholder group deadlocked over the future of the company.

The opposition group—known as the Committee to Restore Value at Sallie Mae (CRV)—at a special meeting of its own last week also was unable to garner a majority of the firm's shareholders for its proposal.

The sides are in a "dead heat" at the moment, Sallie Mae chief executive Lawrence A. Hough said after management's special shareholder meeting yesterday in Tysons Corner.

Slightly more than 80 percent of the shareholders have spoken, and they have split just about 50-50, he said, giving each faction slightly more than 21 million shares so far. Both groups adjourned their meetings in hopes of picking up more votes, either from shareholders who have not yet voted or from those who decide to switch.

The two sides also are negotiating with each other over possible compromises. The company's stock is concentrated largely in the hands of a number of large holders, such as mutual funds and money managers, and persuading one or two of them to switch probably would decide the issue, management officials said.

The largest holder is FMR Corp., parent of the Fidelity group of mutual funds. Also among the top five are Scudder Stevens & Clark, and AIM Management Group, which manage mutual fund money.

Sallie Mae, based in the District, is a government-sponsored enterprise. It is owned by private stockholders but it holds a federal charter and a portion of its board of directors is appointed by the president of the United States. Its mission has been to buy government-guaranteed student loans to provide additional capital to the education market.

Under the Clinton administration, the government has begun making student loans itself, raising questions about Sallie Mae's future. The company last year requested and received permission from Congress to convert to a fully private corporation, subject to shareholder approval.

Both Hough and CRV leader Albert L. Lord emphasized that they favor privatization and that the vote shows that an overwhelming majority of the stockholders favor that as well. They differ, however, on matters of corporate governance and business strategy.

For example, Lord would like to see the company begin making student loans itself rather than merely buying them from lenders. Hough argues that would put the company in competition with its customers, which perhaps might decide not to do business with it.

Since neither plan has won a majority from shareholders, "the writing's on the wall," Hough said. "There's something about these two plans they do not like."

He said management will talk to shareholders and to the CRV, and is willing to revise its plan to meet shareholder demands.

"There is a formulation of an amended plan that will move our numbers. Far enough? Don't know. But we're going to run at 'em. And ultimately there's a way to get privatization done," Hough said.

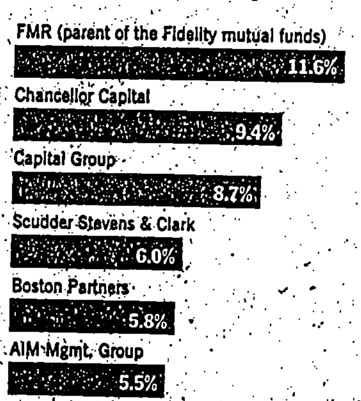
Lord said his reading is that the shareholders want privatization but are rejecting a "cram down" of a management "entrenchment" that management has tied to the privatization issue.

Late yesterday, his group proposed splitting up the issues and taking separate votes on privatization per se, and then on competing slates of directors.

Management said it would study the proposal.

MAJOR STOCKHOLDERS

A large portion of Sallie Mae stock is held by mutual fund companies and money managers. Here are the top holders:



THE WASHINGTON POST

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The Washington Post
FRIDAY, MAY 16, 1997

Gene S
what does this mean?