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Folder Title:
Sallie Mae Offset Fee

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- secondary [illegible]

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SallieMae

NEWS RELEASE

For Immediate Release

Contact:
Gisela Vallandigham
(202) 298-3147
Ross Kleinman
(202) 298-3013

U.S. District Court Sets 90-day Deadline for Department of Education on Sallie Mae Offset Fee

Washington, D.C., April 29, 1997 -- U.S. District Court Judge Stanley Sporkin has ordered the U.S. Department of Education to decide by July 31, 1997, on its final position on the application of a 30 basis point offset fee on loans which Sallie Mae (NYSE: SLM) has securitized.

On January, 10, 1997, the U.S. Court of Appeals for the District of Columbia Circuit struck down the Secretary of Education's interpretation that the 30 basis point offset fee (contained in the Omnibus Budget Reconciliation Act of 1993) applies to any loan in which Sallie Mae holds a direct or indirect interest, including securitized student loans. The Court of Appeals ruled that the fee applies only to loans that Sallie Mae owns and remanded the case to the District Court with instructions to remand the matter to the Secretary of Education. In addition, the Court of Appeals upheld the constitutionality of the offset fee, which applies annually with respect to the principal amount of student loans that Sallie Mae holds and that were acquired on or after August 10, 1993.

"We're pleased with the action by the District Court," said Sallie Mae Executive Vice President and General Counsel Timothy G. Greene. "This means that the Secretary must act promptly and any decision must be consistent with the Court of Appeals' ruling." Greene added that Sallie Mae firmly believes it does not own the securitized loans and the fee therefore is not applicable to them but noted that the company cannot predict what action, if any, will be taken by the Secretary or whether any such action will result in further litigation.

Sallie Mae is the nation's largest holder and servicer of federally guaranteed education loans originated by banks and other lenders under the Federal Family Education Loan Program (FFELP). The Omnibus Budget Reconciliation Act of 1993 imposed the basis point fee -- targeted exclusively at Sallie Mae -- on substantially all guaranteed student loans purchased by Sallie Mae on or after August 10, 1993, as an annual obligation on such loans.

* * *

Sallie Mae, a stockholder-owned (NYSE) corporation, is the nation's leading provider of financial services for postsecondary education needs. The corporation is the nation's largest source of funding and servicing support for education loans for students and their parents.

# # #

5/11/95

DIFFERENCE BETWEEN P~~ROPOSED~~ GSE AND ABS SECURITIES

	GSE	ABS
Preferential treatment as investment/collateral for banks, thrifts, pension funds, etc.	Yes	No
State tax exemption - interest income	Yes	No
Exempt from SEC registration	Yes	No
Money Market eligible	Yes	No
Fedwire book-entry trading	Yes	No
Repo eligible	Yes	No
Principal element of Credit Rating	Implicit U.S. backing	Asset quality
Principal pricing factor (exclusive of transaction structure)	Implicit U.S. backing	Asset quality

true for GSE debt, not mortgages

-Loans sold @ par, and agreement includes a par over rate of 5M (a deferred premium of $1MB)

ENT-66 IMPOSE A COST-OF-CAPITAL OFFSET FEE ON FANNIE MAE AND FREDDIE MAC

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	700	700	700	700	700	3,500
Outlays	700	700	700	700	700	3,500

The interest rate that a firm must pay to borrow money depends on its credit rating. Greater financial strength in a borrower implies a higher level of credit quality (that is, less risk to the lender) and generally lowers the interest and other costs that borrowers must pay to obtain funds. But financial strength--especially when it is based on large amounts of shareholder-provided equity--comes at a price: shareholders must be compensated for the use of their money, which is tied up in raising the credit rating of the company.

The federal government helps government-sponsored enterprises (GSEs) reduce the cost of money from all sources by putting what is essentially the government's seal of approval on the GSEs' financial obligations. (A GSE is an enterprise that is established and chartered by the government for a specific financial purpose but is wholly owned by private stockholders.) That seal of approval consists of several provisions of law, including one that exempts the GSEs from many federal and state regulations designed to protect investors. Through such laws, the federal government sends a signal to investors that securities issued by a GSE are less risky than the GSE's financial condition would suggest. In other words, the federal government is a "shadow" provider of equity capital to the GSE: it stands in for other investors whose capital would be required in the government's absence to bolster the GSE's credit rating, and who would demand compensation for the use of their money.

As a consequence of the federal "presence," GSEs are able to obtain funds in the capital markets at lower interest rates than those paid by fully private borrowers of comparable financial condition. Although estimates are uncertain, two of the GSEs, the Federal National Mortgage Association (FNMA, or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac), probably save more than 30 cents (30 basis points) every year on every $100 of long-term debt they have because of their affiliation with the federal government. On mortgage-backed securities issued and guaranteed by the two GSEs, the cost advantage is smaller; nevertheless, it probably exceeds 5 cents (5 basis points) for every $100 of securities outstanding each year. Although those amounts might seem to be a small benefit, they add up to over $1.5 billion per year because Freddie Mac and Fannie Mae have over $1 trillion in outstanding securities. GSEs do not pay the government a fee or any other compensation for the reduced cost of capital they enjoy as a result of their status as sponsored enterprises.

More than 20 years ago, the federal government chartered Freddie Mac and Fannie Mae to give local, retail mortgage lenders a conduit to the vast sums of money available in the bond markets. In doing so, the government hoped to avoid periodic credit shortages for home buyers. Federal policy to give mortgage lenders access to Wall Street through Fannie Mae and Freddie Mac has clearly succeeded. In successfully channeling money from investors to home buyers and back to investors, the housing GSEs have demonstrated the profitability of such activity. As a consequence, credit is now reliably available to home buyers at all times. But an unfortunate side effect has been that the two GSEs now virtually monopolize the resale, or "secondary," market for fixed-rate home mortgages. In 1993, the volume of mortgages purchased by Fannie Mae and Freddie Mac exceeded one-half of all single-family mortgages that were originated. The GSEs dominate the market in part because the federal government's seal of approval helps reduce the cost of their borrowing.

An offset fee equal to one-half of the savings in capital costs that Freddie Mac and Fannie Mae derive from federal affiliation would be a step toward more equitable competition. In addition, it would compensate taxpayers for the value of the capital services that the government provides. Because of the differential effect of federal affiliation, separate fees should be applied to the GSEs' debt and to mortgage-backed securities (MBSs). (Such securities essentially give their buyers rights to share in the future stream of income generated by a large pool of mortgages put together by the GSE.) One-half of the estimated 30-basis-point saving on debt and one-half of the 5 basis-point-saving on MBSs imply a fee schedule of 15 and 2.5 basis points on the average amount of debt and of MBSs, respectively, that are outstanding each year. Outstanding debt and MBSs for the two GSEs currently stand at about $1.3 trillion ($300 billion of debt and $1 trillion of MBSs). Under the fee schedule proposed in this option, in 1994 federal revenues would have increased by about $700 million based on the GSEs' currently outstanding obligations.

Initially, the fee would reduce the GSEs' earnings, which are projected to total about $3 billion this year. The fee could also raise interest rates on mortgages that have a face value of $203,150 or less and that are eligible for purchase by Freddie Mac or Fannie Mae. If the GSEs were unable to shift any of the cost of the fee to others, their return on their shareholders' investments would fall by about one-fourth--Fannie Mae's from a projected 24 percent and Freddie Mac's from a projected 20 percent. But two effects would be likely to dampen the consequences of the fee for the GSEs' earnings. First, Freddie Mac and Fannie Mae would pass the fee on to others by charging higher interest rates on new mortgage purchases and higher fees on new MBSs. Second, both entities would be likely to shift their funding toward MBSs and away from debt securities, thus lowering the amount of fees they would have to pay. If the entire fee was passed on, home buyers could face interest rates that were up to 0.1 percentage point higher.

The fee discussed here has characteristics of both a user fee and a tax. That ambiguity makes it unclear whether the proceeds should be shown on the revenue side of the budget as governmental receipts or on the spending side as offsetting collections. On balance, however, the charge seems more closely to resemble a fee for services than a tax. Accordingly, this option credits collections from the fee to a Treasury account as offsetting receipts, which are paid into the general fund. That same treatment has been applied to such fees proposed in the budget requests of previous Presidents.

Several federal agencies, including the Congressional Budget Office, are now studying the feasibility and desirability of restructuring Freddie Mac and Fannie Mae into fully private firms. If the Congress decided to sever the federal government's links to these GSEs and revoke its "seal of approval," the cost-of-capital offset fee would need to be repealed.

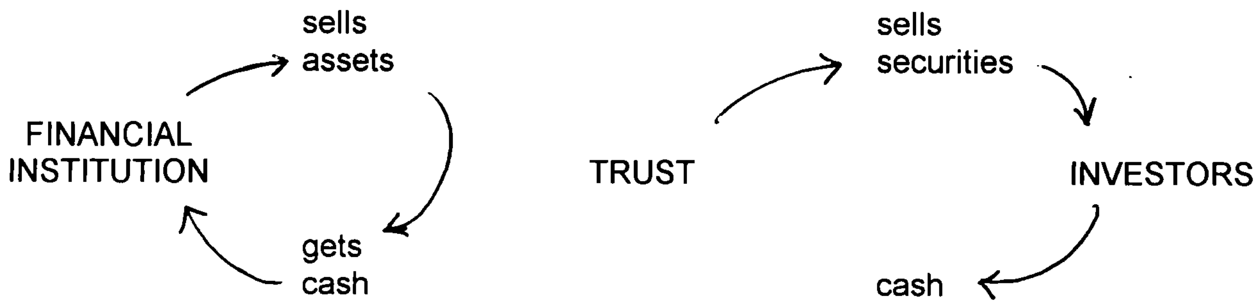
LOAN SECURITIZATION

The concept of loan securitization was developed in the residential mortgage market during the 1970's and has expanded to virtually all areas of finance. In addition to mortgages, securitization has been used for consumer loans (e.g., automobile loans and credit card receivables), commercial real estate, equipment leases, corporate bonds and recently, student loans.

HOW SECURITIZATION WORKS

Asset-backed securities are created when a secondary market acquires loans and "pools" them together as collateral for securities whose yield is tied to the earnings on the pooled assets. The securities are offered for sale, whether publicly or privately, and each investor that buys a portion of the offer receives a proportionate share of the "pooled" cash flow from the assets. Payments collected each month are "passed through" to the investor by the secondary market that issued the security.

Most asset-backed securities are mirror images of the assets in the pools which underlie them so as the loans pay down, the security winds down as well.



WHY LOANS ARE SECURITIZED

The essence of securitization and what distinguishes it from a normal bond issuance is the off balance sheet nature of the transaction. In addition, because the rating on the security is determined by the structure and quality of the collateral (e.g.--the loans in the pool), financial institutions can frequently obtain higher ratings (and thus lower costs) of financing through securitization then through corporate debt issuance.

STUDENT LOAN SECURITIZATION AND SALLIE MAE

A 1992 SEC ruling opened the door for securitization of student loan assets. Some banks have already pioneered such issues, and more issues can be expected over the next few years as a result of the expansion of loan eligibility enacted as part of the Higher Education Amendments of 1992. But as time goes on, direct lending will shrink the potential for growth in the FFEL market. Sallie Mae's support will be crucial for the FFEL program to remain viable as lenders begin to exit the program and as the demand of last resort increases.

As a private entity, without access to the agency capital markets to support the bulk of its student lending activities, Sallie Mae will look to securitization as a means for ensuring the flow of funds to support FFEL loan purchases. The remaining GSE will have access to agency markets if necessary to meet capital needs for last resort origination. Given the precedents established in the mortgage arena and recent forays into the asset-backed securities market by large holders of student loans, Sallie Mae expects that student loan securitization will prove to be a substantial enhancement to its capital base.

Judy Kennedy + 2/97

- S.M. Securitization

- Treasury view ?.3

Allen 4/2/97

- Does S.M. guar -
  timely pmt of principal + interest?

* Get their ABS documents

** Key: to what extent is S.M. resp. to holder for timely payment of prin. + interest. Look @ prospectus.

i.e. who has the credit risk.

- How differentiate from a sponsoring agency??

- SEC documents say they'll transfer to subsids of the fees or applied to securitized loans.

Robert M. Shireman

03/11/97 02:28:55 PM

Record Type: Record

To: Barry White/OMB/EOP

cc: Patricia A. Smith/OMB/EOP

Subject: Re: TREASURY objection to student loan draft bill

FYI, part of the reason I was willing to say we wouldn't fall on our sword is that I'm worried about our position on securitization. Consider this analogy to securitization: I own and manage a 20-unit apartment building. The city imposes a property tax on the property of anyone with more than 10 apartments. I sell five apartments to Pat (holding a one-percent residual interest), with an agreement that I would continue to manage them, for a fee. She is taking the risk: if there is a fire or a destructive tenant, it's her loss (99%). I pay the tax on my 15 apartments, but the city decides I'm skirting the law and tells me that I have to pay the property tax on Pat's five apartments, too, because I used to own them and am still managing them.

The city woudl be on very shaky ground. The city could tax Pat (along with other similarly situated individuals). It could tax apartment management contracts, perhaps. But taxing someone for property he used to own is odd.

ED's position is that Sallie Mae is not using "traditional" securitization, but is actually holding on to greater control and financial interest in the trusts than is the industry standard. ED could not give me any experts on that point other than Don F. I asked a financial analyst (who has no financial interest in S.M. and did not know why I was asking), and he determined that Sallie's securitization instruments do **not** differ markedly from the industry standard.

The next appropriate step would probably be for me to go back to folks at ED with my concerns and see if they can defend their position.

Any thoughts?

[redacted]

Record Type: Record

To:

cc:
Subject: Shamed

Yes, Larry Hough met with the Director on March 3. It made me 45 minutes late for my appearance on a panel at a conference of direct loan schools. It was okay, though, because I got to blame my tardiness on Sallie Mae.

Hough had three points:

1. Industry is working together, not fracturing like in the past. The industry supports the Goodling/Jeffords desire for a "pass" in reconciliation. The President's budget drives changes a year earlier than Congress is prepared to deal with [he admitted that the budget leadership on the Hill is not necessarily on the same page]. The President's budget destabilizes FFELP, leading to concerns at schools.

2. Longanecker isn't interested in long-term "structural problems:" Candidate Gore will have a destabilized FFEL and $100 billion in consumer debt on the government's books. Direct loan contractors won't have the sophistication for securitization, etc. Sallie Mae is driving its costs down and can do it cheaply; the Federal government should take advantage of that. Instead, the focus is just on "beating the bank-based system."

3. Securitization proposal in the Budget is unfair. It places fees on things that are not even Sallie's property. How can that be justified?

The Director's response was:

1. Yes, Goodling came to us and said "don't do anything." But we're going to have a five-year budget agreement *this year*. We can't exclude loans. Everything else is **on** the table.

2. Still learning to appreciate Education, Treasury views on a variety of topics. I'm always open to ideas. Talk to Bob.

3. There was a back-and-forth (and over to me) on securitization, with no particular conclusion.

The meeting ended cordially.

3/3/97

~~Hugh~~ w/ POB

Bess Weaver

(1) Industry w/ together, not fractionary like in the past.
= industry support for Gandlg/Jeffords desire for a 'pass' on reconciliation...
- Prez. budg. lowers Δ a yr ahead.
- Appears Coverle basically agrees.

?, is Budget leadership... maybe not on scale of Prez.

- Prez. destabilizes FFELP → concerns @ schools

(2) Structural problems — No retreat from D. Cangarecher in long-term.
Candidate Gore will have destabilized FFEL
+ $100 billion in consumer debt on Fed Gov's books

D.L. Contractors — cdn't manage a securitization transaction...
Sch. → will do it w/ 50 basis pts if we underpinning them.
Shd. take adv of that.

Face us past 'beat the bank system'

(3) Securitization
- where did it come from ?, ?

D

HD m resp.

1. Desc. w/ Leadlng - 'don't do anything'
   - 5 yr. bud. agmt this yr. Can't exclude them; everything else is on the table.

2. Still learning to appreciate all/ideas etc.
   Always open to ideas...

3. Free

February 28, 1997

MEMORANDUM

To: Franklin Raines

Through: Ken Apfel

From: Bob Shireman

Subject: Meeting with Larry Hough, CEO of Sallie Mae

Mr. Hough will want to discuss the student loan proposals in the FY 1998 Budget, especially the Administration's plan to (1) apply the fee that Sallie now pays on its holdings to its securitized loans, and (2) reduce the interest rate to students and the government during the in-school period, when lender costs are low.

This would be a good opportunity for you to encourage Mr. Hough to support the Administration's attempt to rationalize the structure and incentives of the guarantee system. A strengthened guaranteed loan program remains the key to Sallie Mae profits.

The FY 1998 Budget for student loans

The Budget maintains the policy of allowing schools to choose to participate in either the guarantee system (FFELP, or Federal Family Education Loan Program), or in the Direct Loan Program. The Budget reduces lender subsidies by $1.8 billion over five years, recalls $2.5 billion in reserves held by guaranty agencies (as part of a plan to turn them into performance-based administrators of a direct Federal guarantee), and reduces administrative costs by $400 million.

Student-paid fees are cut in half for borrowers in the need-based Stafford program, and are cut by a quarter for other student and parent loans.

The net savings are $3.5 billion over five years.

Securitization

Hough will complain about the Administration's legislative proposal to extend the current fee on Sallie Mae's loan holdings to loans that it has securitized. The provision saves $92 million over five years.

The 1993 reconciliation bill imposed an annual 30 basis point "offset fee" on loans held by Sallie Mae, to compensate for Sallie's GSE advantages. At least in part to avoid paying the fee, Sallie Mae began to securitize loans. The Education Department insisted that the securitized loans should be subject to the fee, because Sallie Mae is not using traditional securitization which would truly separate the portfolio from the company, but instead is maintaining greater control and greater financial interest in the trusts than is the industry norm. A district court, however, ruled that Sallie Mae does not "own" the securitized loans and -- in the absence of evidence that Sallie "intends" to use the procedure for fee avoidance -- accepted Sallie Mae's argument that securitization is just an innovative experiment. The Education Department appealed.

Meanwhile, Education and the Treasury Department were negotiating legislation to privatize Sallie Mae. The Education Department insisted that a provision be included clarifying that Sallie Mae's securitized loans be subject to the offset fee. Sallie Mae objected, and ultimately the Education Department agreed to await the appeals court ruling to determine whether the amendment would be necessary.

On January 10, 1997, the appeals court ruled for Sallie Mae. In its FY 1998 Fall budget submission, Education had already proposed again to clarify the provision so that the securitized loans would be subject to the fee, for five-year savings of $92 million. OMB concurred.

Sallie Mae officials claim they had not expected that the provision would be in the FY 1998 Budget. Some of them erroneously thought that Education had agreed to *abide* by the appeals court decision, when in fact Education only agreed to *await* the decision before taking any action. There is absolutely no question that Sallie Mae is wrong on this point.

Treasury now wants to encourage faster privatization for Sallie Mae (the bill its former officials negotiated allows over a decade), and thinks that securitization is a step in that direction. Our view is that if securitization provides Sallie Mae with a way to avoid the fee without actually privatizing, it may be a disincentive to privatization. The statutory language for the securitization provision remains important.

<u>Reduced subsidies in the FY 1998 Budget</u>

Hough will express concern that the savings proposals in the Budget (combined with a change in interest rates that is scheduled under current law to begin in FY 1998) are too severe and will not sustain the guaranteed loan program. There is no evidence Education or we are aware of to support this view and nothing in the history of the program to suggest it.

The Budget reduces lender subsidies in the student loan program by $1.8 billion, similar to the total reductions (but different in the components) that were in the Republicans' 1995 reconciliation bill. More than $1 billion of the savings are from a 100 basis point reduction in the in-school interest rate (paid by the government). During this period, lenders have virtually no cost.

Under the plan, the Education Department would pay the government's borrowing rate --

currently assumed to be a meld of 10- and 20-year Treasury bonds, which is assumed to be the cost of money; however, the rate would be adjusted annually, so lenders are still likely to finance loans with shorter-term securities, which would generally provide them with a small spread during the low-cost in-school period. During repayment, the interest rate is scheduled (under current law) to change to the 10-20 year Treasury rate plus one percentage point, adjusted annually.[1]

The Budget also reduces the guarantee from 98% to 95%, and requires lenders to offer the same flexible repayment options (except income-contingent) that are offered in the Direct Loan Program.

Creating a rational, straightforward guarantee system

Notwithstanding his animosity toward the Administration and direct loans and any budget savings, this may be a good opportunity to encourage Hough to support the Administration's proposal to reform the guarantee system. Some lenders have privately expressed support for the concept of a straightforward Federal guarantee, administered (to the extent necessary) through performance-based agreements with the best of the current guaranty agencies or by private contractors. (This change allows for the return of $2.5 billion in reserves held by the agencies).

The GAs are the weakest management link in the system (albeit politically one of the strongest). The guarantee system has already responded to the threat of the more efficient direct loan system by self-initiated reforms and efficiencies that can stop the growth of direct lending. A major guarantee system reform of the type heralded by the Administration's proposals can only improve the outlook for growth in guaranteed loans, the heart of Sallie Mae profits.

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[1]This change was made in the 1993 reforms in an attempt to match the interest rate to the discount rate that OMB has used for the loan programs. It does not match lender costs, however, because lenders match the student loan's variable interest rate with short-term securities, while OMB has held to its Credit Reform Act interpretation that a long-term Treasury bond is most "comparable" to a student loan which tends to be paid back over 10 or more years. The current rate paid by students (or by the government) is T-bill plus 3.1 percentage points, or T-bill plus 2.5 points during the in-school period.

Ethan Segal

- specialists in asset-backed securities

- pretty std. - sep co. takes the risk

- run-of-the-mill, resp. way...

$8 trillion '97 saving $8 million before, $50 after $1 plus.

- NO, nothing gave them greater control or interest.

Cag

1 Ed

2 Disc

Monday: [illegible] + [illegible]

1% partnership
unless in the trust

loans made under sections 428C, 439(o) or 439(q))--

"(i) owned, in whole or in part, by the Association, any subsidiary of the Association, or any company, trust ~~or~~ other entity owned by, controlled by, or otherwise related ~~to~~ the Association; or

"(ii) held by a trust (including by a trustee on behalf of a trust), or by any other entity in which the Association, or any subsidiary or related company or entity, holds more than a minimal beneficial interest (as determined by the Secretary).".

— what is significant?

DIRECT LOAN ORIGINATION FEE

SEC. 6114. Section 452 of the Act is amended--

(1) by striking out subsection (b); and

(2) by redesignating subsections (c) and (d) as subsections (b) and (c), respectively.

FUNDS FOR ADMINISTRATIVE EXPENSES

SEC. 6115. Section 458(a) of the Act is amended--

(1) in the first sentence therein, by striking out "$260,000,000" through the end thereof and inserting in lieu thereof the following: "$532,000,000 in fiscal year 1998, $610,000,000 in fiscal year 1999, $705,000,000 in fiscal year 2000, $806,000,000 in fiscal year 2001, and $904,000,000 in fiscal year 2002.".

SM

Roger Roberson

622-2640

[illegible] ...

"(G)(i) Notwithstanding any other provision of this section, in the case of loans made or insured on or after October 1, 1997, the special allowance paid pursuant to this subsection shall be computed for any 12-month period beginning on July 1 and ending on June 30 by--

"(I) determining the bond equivalent rate on the preceding June 1 of the securities with a comparable maturity, as established by the Secretary; and

"(II) subtracting the applicable interest rate on such loans from such amount.

"(ii) The amount of special allowance computed under clause (i) shall be paid in quarterly increments for the 3-month periods described in paragraph (1)."; and

(B) in paragraph (3), in the second sentence therein, by striking out "determined for any such 3-month period shall be paid promptly after the close of such period," and inserting in lieu thereof "calculated under this subsection shall be paid promptly after the close of the 3-month period for which such special allowance payment is due,".

STUDENT LOAN MARKETING ASSOCIATION OFFSET FEE

SEC. 6113. (a) Section 439(h)(7) of the Act is amended by adding at the end thereof following new subparagraph:

"(D) The calculation of the fee required under subparagraph (A) or (B), as the case may be, shall be determined on the basis of the principal amount of all loans (except for

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Through: Ken Apfel

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[1]This change was made in the 1993 reforms in an attempt to match the interest rate to the discount rate that OMB has used for the loan programs. It does not match lender costs, however, because lenders match the student loan's variable interest rate with short-term securities, while OMB has held to its Credit Reform Act interpretation that a long-term Treasury bond is most "comparable" to a student loan which tends to be paid back over 10 or more years. The current rate paid by students (or by the government) is T-bill plus 3.1 percentage points, or T-bill plus 2.5 points during the in-school period.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

Bob – For your review.

Barry brought his George Brown & I made them.

Bert

Barry — For your review. B

MEMORANDUM

To: Franklin Raines

Through: Ken Apfel

From: Bob Shireman

Subject: Meeting with Larry Hough, CEO of Sallie Mae

Mr. Hough will want to discuss the student loan proposals in the FY 1998 Budget, especially the Administration's plan to (1) apply the fee that Sallie now pays on its holdings to its securitized loans, and (2) reduce the interest rate to students and the government during the in-school period, when lender costs are low.

This would be a good opportunity for you to encourage Mr. Hough to support the Administration's attempt to rationalize the structure and incentives of the guarantee system. A strengthened guaranteed loan program remains the key to Sallie Mae profits

The FY 1998 Budget for student loans

The Budget maintains the policy of allowing schools to choose to participate in either the guarantee system (FFELP, or Federal Family Education Loan Program), or in the Direct Loan Program. The Budget reduces lender subsidies by $1.8 billion over five years, recalls $2.5 billion in reserves held by guaranty agencies (as part of a plan to turn them into performance-based administrators of a direct Federal guarantee), and reduces administrative costs by $400 million.

Student-paid fees are cut in half for borrowers in the need-based Stafford program, and are cut by a quarter for other student and parent loans. The net savings are $3.5 billion over five years.

Securitization

Hough will complain about the Administration's legislative proposal to extend the current fee on Sallie Mae's loan holdings to loans that it has securitized. The provision saves $92 million over five years.

The 1993 reconciliation bill imposed an annual 30 basis point "offset fee" on loans held by Sallie Mae, to compensate for Sallie's GSE advantages. At least in part to avoid paying the fee, Sallie Mae began to securitize loans. The Education Department insisted that the securitized loans should be subject to the fee, because Sallie Mae is not using traditional securitization which would truly separate the portfolio from the company, but instead is maintaining greater control and greater financial interest in the trusts than is the industry norm. A district court, however, ruled that Sallie Mae does not "own" the securitized loans and -- in the absence of evidence that Sallie "intends" to use the procedure for ~~wholesale~~ fee avoidance -- accepted Sallie Mae's argument that securitization is just an innovative experiment. The Education Department appealed.

Meanwhile, Education and the Treasury Department were negotiating legislation to privatize Sallie Mae. The Education Department insisted that a provision be included clarifying that Sallie Mae's securitized loans be subject to the offset fee. Sallie Mae objected, and ultimately the Education Department agreed to await the appeals court ruling to determine whether the amendment would be necessary.

On January 10, 1997, the appeals court ruled for Sallie Mae. In its FY 1998 Fall budget submission, Education had already proposed again to clarify the provision so that the securitized loans would be subject to the fee, for five-year savings of $92 million. OMB concurred.

Sallie Mae officials claim they had not expected that the provision would be in the FY 1998 Budget. Some of them erroneously thought that Education had agreed to *abide* by the appeals court decision, when in fact Education only agreed to *await* the decision before taking any action. There is absolutely no question that Sallie Mae is wrong on this point.

(the bill its former officials negotiated allows over a decade)

Treasury now wants to encourage faster privatization for Sallie Mae, and thinks that securitization is a step in that direction. Our view is that if securitization provides Sallie Mae with a way to avoid the fee without actually privatizing, it may be a disincentive to privatization. ~~We are working with Treasury and Education to on~~ The statutory language for the securitization ~~provision~~ remains important.

<u>Reduced subsidies in the FY 1998 Budget</u>

Hough will express concern that the savings proposals in the Budget (combined with a change in interest rates that is scheduled under current law to begin in FY 1998) are too severe and will not sustain the guaranteed loan program. There is no evidence Education or we are aware of to support this view and nothing in the history of the program to suggest it.

The Budget reduces lender subsidies in the student loan program by $1.8 billion, similar to the total reductions (but different in the components) that were in the Republicans' 1995 reconciliation bill. More than $1 billion of the savings are from a 100 basis point reduction in the in-school interest rate (paid by the government). During the period lenders have virtually no cost. Under the plan, the Education Department would pay the government's borrowing rate -- currently assumed to be a meld of 10- and 20-year Treasury bonds, which is assumed to be the cost of money. However, the rate would be adjusted annually, so lenders are still likely to finance loans with shorter-term securities, which would generally provide them with a small spread during the low-cost in-school period. During repayment, the interest rate is scheduled (under current law) to change to the 10-20 year Treasury rate plus one percentage point, adjusted annually.[1]

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[1]This change was made in the 1993 reforms in an attempt to match the interest rate to the discount rate that OMB has used for the loan programs. It does not match lender costs, however, because lenders match the student loan's variable interest rate with short-term securities, while OMB has held to its Credit Reform Act interpretation ~~assumed~~ that a long-term Treasury bond is most "comparable" to a student loan which tends to be paid back over 10 or more years. The current rate paid by students (or by the government) is T-bill plus 3.1 percentage points, or T-bill plus 2.5 points during the in-school period.

Barry White
02/13/97 09:28:58 AM

Record Type: Record

To: Patricia A. Smith/OMB/EOP

cc: Kenneth S. Apfel/OMB/EOP, Robert M. Shireman/OMB/EOP
Subject: Re: how ED will decide the amount of reserve funds to be recalled from each GA

Hmmm. Not good enough. They have to also have a procedure whereby they determine whether losing that share will have a deleterious effect on that GA's solvency. We can't have ED accused of precipitating bankruptcy. If bankruptcy is inevitable for a given agency, then it should be the subject of a winddown anyway, and that should be taken into account. Please verify the procedure.

The Budget also reduces the guarantee from 98% to 95%, and requires lenders to offer the same flexible repayment options (except income-contingent) that are offered in the Direct Loan Program.

Creating a rational, straightforward guarantee system

This may be a good opportunity to encourage Hough to support the Administration's proposal to reform the guarantee system. Some lenders have privately expressed support for the concept of a straightforward Federal guarantee, administered (to the extent necessary) through performance-based agreements with the best of the current guaranty agencies or by private contractors. (This change allows for the return of $2.5 billion in reserves held by the agencies).

Notwithstanding his animosity toward the Administration + Direct Loans and any budget savings,

¶ The GAs are the weakest management link in the system (albeit politically one of the strongest). The guarantee system has clearly responded to the threat of the more efficient direct loan system by self-initiated reform + efficiencies that can ~~[illegible]~~ stop the growth of direct lending. A major guarantee system reform of the type heralded by the Administration's proposal can only improve the outlook for growth in guaranteed loans, the heart of Sallie Mae profits

Ellen S. Seidman
02/25/97 04:00:00 PM

Record Type: Record

To: Robert M. Shireman

cc:
Subject: Re: School construction

Message Creation Date was at 25-FEB-1997 16:00:00

Now you know just how much in the loop I am. Obviously one question is whether Gene told Andy to give the Dems the bill before or after I spoke to Andy. In any event, what's done is done, and Collins is here. I've sent an e-mail to Gene telling him of Collins interest and asking what he proposes. Presumably, if he really told Andy to give them the bill (I'm not doubting Andy), Gene will have that information as he decides what to do with Steve.

On securitization, Roger and I had the kind of discussion that included lines like "let me tell you about the budget process," and regaling him with tales of the state bank fee and the FHA loan limit increase -- with the ultimate message that what's done is done, and your trick is to figure out (i) how to live with it and (ii) how to minimize the damage. I asked him to think about such questions as (i) do you really in your heart of hearts truly believe that this will make a difference in how fast they privatize and (ii) if it's even up now and Sallie is still pushing to securitize, how big a fee will it take (a) now and (b) when the market is much bigger, to stop them? He'll get back to me, but I assume I'll have to listen to a fair amount more Treasury diatribe on the unfairness of the process. You might get some too.

To: Barry
Bob

Bob -
please get the answer to this at early in the week.
BW
2/21

FAX COVERSHEET
U.S. DEPARTMENT OF THE TREASURY
OFFICE OF THE UNDER SECRETARY
FOR DOMESTIC FINANCE

Date: 2/12/97

To: Ken Apfel
Fax #: 395-5730 **Phone #:**

From: Jerry Hawke

Fax #: 202/622-0387 **Phone #:** 202/622-1703
Total # of Pages: 2

Comments/Remarks:

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 11, 1997

MEMORANDUM FOR John D. Hawke, Jr.
Under Secretary (Domestic Finance)

FROM: Roger L. Anderson RLA
Deputy Assistant Secretary
(Federal Finance)

SUBJECT: Proposed Offset Fee on Sallie Mae

The President's budget proposes that the current 30 basis point offset fee on Government-guaranteed student loans (GSLs) purchased and held by Sallie Mae should be extended to loans that the GSE sells into securitization vehicles. Last year, the Court of Appeals for the D.C. Circuit ruled that Sallie Mae's securitized GSLs are not subject to the fee under current law. The budget proposal is the Department of Education's (DED) latest effort to legislate its way out of the unfavorable court decision.

The budget proposal, which was not coordinated at the policy level, is at odds with Treasury's position that GSE status should be terminated as soon as possible, hopefully before the required end date of either September 30, 2008 or July 1, 2013. GSE operations could be extended if the fee reduces securitization and limits shrinkage in Sallie Mae's balance sheet.

The fee would remove the immediate incentive for Sallie Mae to substitute higher cost securitized financing for lower cost GSE debt. The cost of securitization over GSE debt is about 30 basis points, or about equal to the cost of GSE debt plus the offset fee. Securitization plus a 30 basis point fee would result in uneconomical financing for Sallie Mae.

Sallie Mae might also have to put up additional capital to meet its statutory capital requirement if legislation to levy the fee declares that Sallie Mae still "holds" GSLs after securitization. The threat to profitability and capital management could hamper securitization substantially in a company already under shareholder pressure to reduce costs and conserve capital. The worst case scenario is that the fee might elicit shareholder rejection of privatization. The Holding Company's success in becoming a well-established issuer of asset-backed securities that bear none of the benefits of agency debt is central to Sallie Mae's success under privatization.

The budget proposal is also at odds with an agreement reached last year between senior officials of Treasury, OMB, and DED. At that time, everyone agreed to accept the court decision regarding the fee on securitized GSLs. DED appears intent on using legislation to tie up Sallie Mae resources, perhaps to protect the Direct Student Loan Program from its major competitor.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE GENERAL COUNSEL

DIVISION OF POSTSECONDARY EDUCATION

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Washington, D.C. 20202-2110
Tel. (202)401-8302
Fax. (202)401-9533

FACSIMILE TRANSMISSION COVER SHEET

Brian Siegel

DATE: 2-19-97

TO: Pat Smith
Bob Shireman] OMB

FAX NO: 395-4875

FROM: Brian Siegel

NUMBER OF PAGES INCLUDING COVER SHEET: 2

COMMENT: I've noted a few technical corrections on the draft language for the response to Treasury. Personally, I would love to see OMB tell Treasury that whether or not Sallie Mae privatizes is not a priority issue that should control ~~policy~~ other ~~policy~~ policies but I can certainly appreciate your choice not to do so. Call me if you have any questions.

Sallie Mae Offset Fee

The Administration's position, both in the courts and in last year's balanced budget proposal, has been that the particular type of securitization vehicles that Sallie Mae has used should not exempt them from the 30 basis point fee imposed by the Student Loan Reform Act of 1993.

The ~~continuation~~ addition of this policy to the Higher Education Act through in the FY 1998 budget process would in no way undermine the incentives for privatization. Indeed, the opposite is probably true. The current situation allows Sallie Mae to escape the fee without privatizing, because the company can continue to hold a substantial interest in and control over the securitized loans. Under the Administration's proposal, the best way to avoid the fee is to privatize, or to use a more traditional securitization structure in which Sallie Mae would hold at most a minimal interest.

I would note that in documents recently filed with the SEC -- in which companies must warn of any risks to investors -- Sallie Mae did not indicate that the application of the offset fee to securitized loans would undercut the success of either privatization or securitization.

Finally, I think that you will recall that the agreement reached last year on this issue was only that, since a court decision was pending, the Administration would not insist that this provision be included with the Sallie Mae privatization proposal. There was no change in the Administration's position that it is not in the public interest to allow a GSE to escape application of an offset fee through this type of securitization.

holding co.

subsidiary

affiliate

SLMA

UNITED STATES DEPARTMENT OF EDUCATION

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FACSIMILE TRANSMISSION COVER SHEET

DATE: 2-12-97

TO: ~~Pat Smith~~ Bob
OMB

FAX NO: 395-4875

FROM: Brian Siegel

NUMBER OF PAGES INCLUDING COVER SHEET: 3

COMMENT: Here's a proposed response to Roger Anderson of Treasury - feel free to use whatever you want. Let me know if you have any questions

SUBJECT: Proposed Offset Fee on Sallie Mae

This is in response to your memorandum of February 11, 1997, criticizing the proposal in the President's budget that would extend the 30 basis point offset fee on government guaranteed student loans to loans that Sallie Mae sells into securitization vehicles. You believe that the proposal is at odds with Treasury's position that Sallie Mae's GSE status be terminated as soon as possible and you speculate that the GSE operations could be extended if the fee reduces securitization.

Contrary to the suggestion in your memorandum, the budget does not propose to apply the offset fee to all loans securitized by Sallie Mae. Instead, the proposal will apply the fee to loans securitized under a structure in which Sallie Mae continues to hold a substantial interest in and control over the loans. The proposal will not extend the offset fee to loans under a more traditional securitization structure where Sallie Mae would hold at most a minimal interest. Nor will the offset fee apply to loans held, in any form, by the privatized Sallie Mae. Thus, the proposal should encourage, and not undercut the privatization process.

It also appears that Sallie Mae does not share your concerns about the effect of the fee on securitization and privatization. Sallie Mae discussed the effect of Education's interpretation of the offset fee in registration statements filed with the SEC in connection with the securitization and in a publicly issued report on privatization. In neither document has Sallie Mae indicated that the application of the fee to securitized loans would undercut the success of either process. Since documents like these are typically cited in lawsuits filed by disgruntled investors, we assume that Sallie Mae carefully considered whether the fee created a risk that it needed to disclose. Sallie Mae obviously has concluded that the application of the fee to securitized loans did not cause such a risk.

Your suggestion that the budget proposal is inconsistent with an agreement reached last year by Treasury, OMB and Education is also inaccurate. Education and OMB agreed to withdraw a proposal to include the corrected offset fee provisions in the Sallie Mae privatization legislation pending a final court decision. Neither agency agreed to forego a legislative correction of a court decision that it believed was not in the public interest.

Finally, I must strongly object to your suggestion that the legislation is intended to "tie up Sallie Mae resources" to benefit the Direct Student Loan Program. As you know, the success of the Direct Loan Program (which the President proposed and has strongly supported) remains a priority of the Administration. However, the offset fee issue has nothing to do with that Program. In fact, the income from the fee pays costs associated with and reduces the direct federal cost of the guaranteed student loan program. The budget proposal will, in fact, improve the budgetary analysis and proper administration of that program. On the other hand, your recommendation that Sallie Mae be allowed to use complex financial and legal structures to avoid imposition of the fee on loans it continues to control suggests that you believe that the success of Sallie Mae's privatization should be the most important consideration to the Administration. We do not share that opinion.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
February 11, 1997

To BW/BS we need a response -KA

MEMORANDUM FOR John D. Hawke, Jr.
Under Secretary (Domestic Finance)

FROM: Roger L. Anderson RLA
Deputy Assistant Secretary
(Federal Finance)

SUBJECT: Proposed Offset Fee on Sallie Mae

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The budget proposal, which was not coordinated at the policy level, is at odds with Treasury's position that GSE status should be terminated as soon as possible, hopefully before the required end date of either September 30, 2008 or July 1, 2013. GSE operations could be extended if the fee reduces securitization and limits shrinkage in Sallie Mae's balance sheet.

The fee would remove the immediate incentive for Sallie Mae to substitute higher cost securitized financing for lower cost GSE debt. The cost of securitization over GSE debt is about 30 basis points, or about equal to the cost of GSE debt plus the offset fee. Securitization plus a 30 basis point fee would result in uneconomical financing for Sallie Mae.

Sallie Mae might also have to put up additional capital to meet its statutory capital requirement if legislation to levy the fee declares that Sallie Mae still "holds" GSLs after securitization. The threat to profitability and capital management could hamper securitization substantially in a company already under shareholder pressure to reduce costs and conserve capital. The worst case scenario is that the fee might elicit shareholder rejection of privatization. The Holding Company's success in becoming a well-established issuer of asset-backed securities that bear none of the benefits of agency debt is central to Sallie Mae's success under privatization.

The budget proposal is also at odds with an agreement reached last year between senior officials of Treasury, OMB, and DED. At that time, everyone agreed to accept the court decision regarding the fee on securitized GSLs. DED appears intent on using legislation to tie up Sallie Mae resources, perhaps to protect the Direct Student Loan Program from its major competitor.