

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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: Master File No. 08 Civ. 1029 (WHP)  
In re: SLM CORPORATION SECURITIES :  
LITIGATION : JURY TRIAL DEMANDED  
:  
-----X

**CONSOLIDATED AMENDED CLASS ACTION COMPLAINT**

U.S. DISTRICT COURT  
S.D.N.Y.

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Lead Plaintiff ("Plaintiff"), by its undersigned attorneys, on behalf of itself and the class it seeks to represent, for its Consolidated Amended Class Action Complaint (the "Complaint"), alleges the following upon personal knowledge as to itself and its own acts, and upon information and belief as to all other matters, based upon the investigation made by Plaintiff's counsel, which included the review and analysis of information obtained from numerous public sources including, *inter alia*: Securities and Exchange Commission ("SEC") filings by SLM Corporation, securities analysts reports about the Company, Company press releases, periodic earnings conference calls held by the Company, media reports about the Company, and interviews with former Sallie Mae employees.

## I. INTRODUCTION

1. This securities class action is brought on behalf of all persons who purchased or otherwise acquired the common stock of SLM Corporation ("Sallie Mae", "SLM", or the "Company") between January 18, 2007 and January 23, 2008, inclusive (the "Class Period"), against Sallie Mae and certain of its officers and/or directors for violations of the Securities Exchange Act of 1934 ("1934 Act").

2. Sallie Mae, through its subsidiaries, provides education finance in the United States. The Company was founded in 1972 and its primary business is to originate and hold student loans by providing funding, delivery and servicing support for education loans. The Company provides its loans by participating in the Federal Family Education Loan Program ("FFELP") and by offering non-federally guaranteed Private Education Loans ("PELs").

3. During the Class Period, Defendants issued materially false and misleading statements regarding the Company's business and financial results. Defendants claimed that SLM maintained an adequate level of loan loss reserves on its student loan portfolios, including

PELs, which carried a high and increasing risk of default and was a material and rapidly increasing part of SLM's total loan portfolio. However, the Company could not truthfully make such representations about the adequacy of its loan loss reserve because SLM systematically failed, during the underwriting process, to obtain adequate and proper credit and other relevant information from borrowers about their ability to repay their loans, and failed to obtain sufficient information during the collection process for delinquent loans about the borrowers' true ability to repay their loans. This was especially true with respect to high-risk PEL borrowers.

4. Because SLM did not have this information, it could not accurately make the good faith estimates necessary to establish adequate loan loss reserves for PELs and, as a result, reported consistently understated loan loss reserves during the Class Period in violation of Generally Accepted Accounting Principles ("GAAP"). In addition, SLM aggressively and systematically pursued and manipulated its forbearance process whereby delinquent student loans, particularly PELs, were removed from delinquency status to the so-called forbearance status for the specific purpose of reducing reported delinquencies, justifying inadequate loan loss reserves for bad loans and concealing from investors the poor and rapidly deteriorating quality of these loans and the inability of borrowers to timely repay these loans.

5. As a result of Defendants' false statements, Sallie Mae's stock traded at artificially inflated prices during the Class Period, reaching its Class Period high of \$57.98 per share in July 2007 and falling to less than \$17 at the end of the Class Period.

6. During the Class Period, Sallie Mae offered loans to students attending both "traditional" schools and "non-traditional" schools. Traditional schools are typically institutions of higher education that are not-for-profit and offer bachelors and graduate degrees. Non-traditional schools are typically educational institutions that are for-profit and offer associate

degrees or vocational, career or technical programs. Non-traditional schools are institutions that are run by private profit-seeking companies or organizations, and loans to students attending those schools are typically not eligible for government guarantee.

7. Graduation is critical to student loan lenders as graduates tend to earn more and experience lower rates of unemployment than non-graduates, both of which are key factors for borrowers being able to repay their student loans. There is a correlation between students graduating from their school and repaying their student loans. The graduation rate at non-traditional schools is much lower than the graduation rate at the traditional schools. Additionally, students attending non-traditional schools tend to have a lower tier credit quality than students attending traditional schools. Many non-traditional students fall into the category of high-risk borrowers.

8. Even though Sallie Mae's loan loss provisions for its growing inventory of high-risk borrowers attending non-traditional schools were inadequate and materially understated by the start of the Class Period, Sallie Mae knowingly or recklessly failed to adequately reserve for losses in its non-traditional and other PEL loan portfolios. Likewise, in its textual and verbal disclosures to investors in its publicly reported financial statements, press releases and investor conferences, the Company concealed and misrepresented the poor quality of its PEL portfolio and its deterioration. Defendants deliberately or recklessly concealed the risk of its loan portfolios by combining, in its public disclosures, the amount and performance of traditional and non-traditional PELs, even though the repayment risk on non-traditional loans was far greater than on traditional loans and defaults on non-traditional loans escalated rapidly during the Class Period.

9. By the end of 2006, SLM also knew that the availability and profitability of government guaranteed student loans was decreasing and would adversely affect the Company's revenues and earnings from that line of business. The Company also knew that the demand for PELs, particularly by students that were attending, in increasing numbers, the non-traditional educational programs offered by for-profit companies, such as the University of Phoenix and Corinthian Colleges had grown rapidly and was continuing to grow. Defendants therefore embarked on a plan to maintain and increase SLM's business and profits by growing its PEL non-traditional business, while misrepresenting and concealing the high and increasing risk to SLM investors from the resulting decreasing credit quality of the Company's loan portfolios. Because PELs were not government guaranteed, they bore much higher interest rates than traditional government guaranteed student loans. However, at no time during the Class Period did Defendants adequately disclose SLM's increasing exposure to high-risk non-traditional student loans, which grew from 11% to 15% of the PEL portfolio during 2007. Defendants only belatedly explained that these non-traditional loans were historically high-risk loans to students who attended for-profit schools and often failed to graduate.

10. During 2005 and 2006, SLM was building its PEL business. Unbeknownst to investors, by the beginning of 2007, the Company had been transformed from a simple purveyor of government-program guaranteed-loans to traditional college and graduate students into a high-risk speculator in loans to students of limited financial and academic qualifications which allowed them to attend for-profit schools that were of only doubtful effectiveness in preparing their students for higher paying jobs that would allow them to repay their high priced loans. Moreover, although Sallie Mae was experiencing a high and increasing level of delinquencies and defaults in its PELs, and particularly in its non-traditional portfolio by the end of 2006,

Defendants kept Sallie Mae's loan loss provisions for its PEL at inadequate levels during the Class Period, thereby allowing Sallie Mae to report materially overstated income or understated losses.

11. After the end of the Class Period and *after* the true risks of SLM's PEL business were at last revealed to the public, Defendants admitted that they had made "mistakes" in being too generous in the underwriting process that qualified students to receive private loans, although they denied awareness of the much greater penchant of non-traditional borrowers to fail to repay their loans.

12. However, the facts alleged herein support a strong inference that Defendants knew (or at least recklessly disregarded) the true risks of the non-traditional PEL business and that SLM was rapidly and significantly expanding its business by granting such loans almost indiscriminately, with little or no regard to the creditworthiness of the borrower. The facts alleged similarly establish that Defendants knowingly manipulated SLM's publicly reported student loan delinquency and loan loss reserves by moving a huge volume of delinquent loans, including those that were many months past due and headed inevitably toward charge-off, into the category of "forbearance loans", thereby materially reducing reported delinquencies and concealing the huge financial risk that made SLM's PEL portfolio an investment time bomb for Plaintiff and other purchasers of SLM stock during the Class Period. Defendants' practice of moving huge volumes of delinquent loans into the forbearance category concealed the accelerating growth of delinquencies recorded during the Class Period – a period during which an ever increasing number of the high-risk PELs granted in 2005, 2006 and early 2007 entered delinquency.

13. By the end of the third quarter of 2007, the principal amount of managed<sup>1</sup> PEL loans in forbearance had risen to over \$1.9 billion, compared to \$1.09 billion of reported delinquent loans. These amounts represent an increase of 73% in the amount of forbearance since year end 2006, compared to an increase of only 8% in delinquent loans for that period. Throughout the Class Period, SLM management systematically and improperly used forbearance, which should be granted only after the lender determines that granting the borrower additional time will improve the borrower's ability to repay the loan and that the debtor will be able to resume making these required payments in the foreseeable future, to remove from its delinquency aging lists loans that were as many as seven months or more past due. SLM did so for the purpose of reducing its reported loan delinquencies because loans placed into forbearance would be "re-aged"; i.e., treated as "current" (no matter how long the prior period of past delinquency) upon exit from forbearance and this process in turn allowed SLM to artificially inflate its reported income by "allowing" it to reduce its provision for loan losses and avoid having to take write-offs (as would otherwise be required by SLM accounting policy) after loans had become more than 212 days past due.

14. When an analyst noticed the large increase in forbearance loans buried in SLM's third quarter 2007 financial report and inquired about it during the Company's October 11, 2007 teleconference, Defendants Andrews and Lord offered false explanations for the increase—that in earlier quarters collection personnel had not been offering forbearance as frequently as it should have been offered, that the granting of forbearance improved the long term collection of otherwise delinquent loans, and that in any event the forbearance increase in the quarter was seasonal and would not increase in the future. In fact, loans in forbearance continued to increase

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<sup>1</sup> SLM analyzes the performance of its student loan portfolio on a Managed Basis, under which the Company views both on-balance sheet student loans and off-balance sheet student loans owned by the securitization trusts as a single portfolio, and the related on-balance sheet financings are combined with off-balance sheet debt.

throughout 2007. Three months after this teleconference, Sallie Mae disclosed in its 2007 Form 10-K that it increased its loan loss provision by \$575 million of its PELs.

15. Similarly, when an analyst questioned why, in the third quarter of 2007, SLM had added \$90 million *less* to the Company's provision for bad loans than it had added in the prior quarter, despite poorer economic conditions in the United States, Defendant Andrews falsely stated, that operational problems at the new Sallie Mae collection facility in Muncie, Indiana had been resolved, with the result that larger collections on delinquent loans were occurring and that a larger provision for bad loans was therefore unnecessary. Andrews further assured participating investors that "charge-off rates and levels and the delinquency rates are trending in the direction that we had expected. . . we expect in the near-term our delinquencies levels and charge-offs to hover around that 3% level". In fact, the lower new provisions were, in part, the result of knowing, improper, systematic reduction of reported delinquencies through improper granting of forbearance. Bad-debt provisions for loans removed from delinquency and placed in the forbearance category, if established at all, were calculated at a lower percentage or fraction of the outstanding loan than were provisions for delinquent loans.

16. Inadequate loan loss provisions also resulted from Defendants' knowing or reckless disregard of the accelerating increase in PELs and other student loan delinquencies and bad faith estimates of required loan loss reserves for those accelerating bad loans. During the Class Period and into January 2008, Defendants, by the above-described methods, deceived the market through a series of related misstatements and non-disclosures and concealed from Plaintiff and the investing public the full risk of investing in SLM. As a result, SLM stock traded at fraudulently inflated levels and Plaintiff and the class members suffered damages from that fraud as the true risk attached to their investment was partially revealed in December 2007, when

SLM announced, among other adverse information, that it was experiencing higher than anticipated delinquencies and reduced expected 2007 financial results, after which SLM's stock price dropped \$3.45 per share on December 12, 2007, to close at \$28.49 per share.

17. Additional adverse information relating to, among other things, the quality and value of SLM's loan portfolios, was subsequently revealed in the weeks that followed. For example, in an 8-K Report filing on January 3, 2008, the Company disclosed that it would be "more selective" in making students loans. After the January 3<sup>rd</sup> 8-K Report and press release, SLM's stock price fell \$2.49 to close at \$16.67 per share, a one-day decline of 15% on heavy trading. SLM's Q4 2007 and 2007 financial results, reported on January 23, 2008 confirmed what the market had already assumed to be true—that SLM's PEL loss reserves were inadequate. In fact, the Company took a huge loan loss provision of \$575 million (on a GAAP basis).

18. On January 23, 2008, Sallie Mae disclosed that it had suffered a tremendous loss in the fourth quarter of 2007 as well as for the year due, in large part, to the need to take an enormous charge to increase its loan loss provision by \$575 million to cover actual and expected loan losses. In total, Sallie Mae's loan loss provision for 2007 was \$1.4 billion compared to \$303 million for 2006. The majority of the large increase in the loan loss provision was related to high-risk PELs made prior to 2007 that were a part of the Company's non-traditional portfolio. SLM provisioned \$782 million for its non-traditional portfolio for 2007, up from \$215 million in 2006, an increase of over 250%. By comparison, SLM provisioned \$438 for its traditional loan portfolio for 2007, up from \$179 million in 2006, an increase of under 150%.

19. In 2007, the Company's non-traditional loans represented 15% of its managed private credit portfolio, which in turn represented 17% federal and private student loans combined. Thus, over 55% of SLM's loan loss reserves in 2007 were attributable to less than

3% of the Company's loans. According to Lord, the non-traditional loan portfolio also resulted in 60% of the total charge-offs for the Company for 2007. As SLM explained in its Form 10-K for the year ended 2007, filed February 29, 2008, the Company had neither used the term "non-traditional" nor reported performance in terms of traditional versus non-traditional loans in any of its previous annual or quarterly filings.

20. Sallie Mae further disclosed in January 2008 that it would be exiting the non-traditional segment and would stop making loans to students who attended schools with very low graduation rates. Three major for-profit secondary-education companies announced that Sallie Mae had notified them that it would discontinue making loans to students at the schools who were classified as high risk borrowers.

21. The true facts, which were known by Defendants or recklessly disregarded, but concealed from the investing public during the Class Period, were as follows:

a. SLM failed to engage in proper due diligence in originating and in granting forbearance for student loans to high risk borrowers, particularly those attending non-traditional institutions;

b. SLM was not adequately reserving for uncollectible loans in its PEL portfolios, and particularly in its non-traditional portfolio, in violation of GAAP, causing its financial results to be materially misstated;

c. SLM was manipulating its reported loans in delinquency by using improper grants of forbearance to non-paying borrowers in order to remove loans from delinquency and to avoid charging-off the loans as uncollectible, to shorten the delinquency period that would otherwise be attributed to non-paying loans and thus to reduce the allowance

for loan loss that would otherwise be established had those loans been correctly classified as delinquent;

d. SLM failed to disclose known trends and uncertainties as required by SEC regulations concerning collection issues with its non-traditional loan portfolio; and

e. SLM had far greater exposure to anticipated losses and defaults, particularly related to its non-traditional loan portfolio, than it had previously disclosed.

22. As discussed in more detail below, on a January 23, 2008 conference call, Defendant Lord announced that “[t]he company has stopped making loans that were predictably not collectible,” referring to non-traditional loans. In a June 5, 2008 interview, Defendant Lord, when asked why SLM had been making non-traditional loans in the first place, replied “It was obviously a mistake and I’m not going to step away from responsibility because I was either chairman or CEO when those loans were made. We got a little too confident in our own view that credit scores are of limited meaning for undergraduates. Maybe as early as 2004, we started lending with less selectivity. The culture of the company has been a FFELP culture for 35 years. That meant you made every loan to every student. I guess with 35 years of experience of saying yes, we were just not very good at saying no.” On September 10, 2008, Defendant Lord, speaking at a Lehman Brothers Global Financial Services Conference, admitted that the Company “began to I think engage in some wishful thinking in our underwriting practices.”

23. In violation of both GAAP and SEC regulations, Sallie Mae’s Form 10-K for the FY ended 2006 and Forms 10-Q for FY2007: (a) failed to accurately disclose Sallie Mae’s forbearance practices; (b) failed to adequately disclose concentrations of risk; (c) failed to provide an adequate loan loss reserve for its traditional and non-traditional private loan portfolio; and (d) disclose known trends and uncertainties related to Sallie Mae’s operations. SLM’s press

releases issued during the Class Period reflected these material false or misleading misstatements.

24. As a result of Defendants' false and misleading statements, investors, including Plaintiff, were misled as to the true financial and business condition of the Company and were deceived about the true risks attached to Sallie Mae's PEL portfolio and Sallie Mae's stock traded at inflated levels during the Class Period. As the truth about the true credit quality of its PEL portfolio and as a result of these false statements, false financial reports and concealment of risk concerning the PEL portfolio and the non-traditional loan portfolio Sallie Mae's stock price traded at inflated levels during the Class Period. As the truth about the true credit quality of the PEL portfolio and the risks attached to that part of Sallie Mae's business were gradually disclosed to the market, the Company's shares fell sharply to less than \$17 per share at the end of the Class Period, compared to a near-all-time high of \$57.98 per share in July 2007 and compared to prices exceeding \$30 per share shortly before the truth began to enter the market beginning in December 2007.

## **II. JURISDICTION AND VENUE**

25. The claims asserted arise under Sections 10(b) and 20(a) of the Securities and Exchange Act, 15 U.S.C. §§78j and 78t(a), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder by the SEC, 17 C.F.R. § 240.10b.5.

26. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. 1331.

27. Venue is proper in this Judicial District pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §(b) and (c). Sallie Mae has operations in this District, false

statements were made in this District, and acts giving rise to the violations complained of occurred in this District.

28. In connection with the acts, transactions, and conduct alleged herein, Defendants directly and indirectly used the means and instrumentalities of interstate commerce, including the United States mails, interstate telephone communications, and the facilities of a national securities exchange.

### **III. PARTIES**

#### **Lead Plaintiff**

29. Lead Plaintiff Westchester Capital Management, Inc. (“Westchester Capital”), as the investment advisor for The Merger Fund and The Merger Fund VL (“Lead Plaintiff”), purchased Sallie Mae common stock during the Class Period and suffered damages as a result of the federal securities law violations alleged herein.

30. By court order dated July 23, 2008, Westchester Capital was appointed Lead Plaintiff in accordance with the provisions of the Private Securities Litigation Reform Act of 1995. Westchester Capital’s certification was previously filed with the Court.

#### **Defendants**

31. Defendant Sallie Mae, through its subsidiaries, provides education finance in the United States. It originates, owns, and manages student loans by providing funding, delivery, and servicing support for education loans through its participation in FFELP and through offering non-federally guaranteed private education loans, or PELs. Sallie Mae stock trades under the symbol SLM on the New York Stock Exchange (“NYSE”).

32. Defendant Albert L. Lord (“Lord”) is Vice Chairman and Chief Executive Officer (“CEO”) of Sallie Mae. Lord initially joined Sallie Mae in 1981 as controller and then served as

executive vice president and chief operating officer. He left the Company in 1994 and returned in 1995 as a director of the Company and became SLM's CEO in 1997. He held this position until 2005 and then, in March 2005, began to serve as Chairman of the Board of Directors until January 2008. Lord was appointed Executive Chairman on November 28, 2007 (and the person to whom the CEO would report) and then re-appointed CEO in December 2007. He was named Vice Chairman of the Board in January 2008.

32. Defendant Charles Elliott (C.E.) Andrews ("Andrews") joined the Company in 2003 as executive vice president of accounting and risk management. He served as Chief Financial Officer ("CFO") of the Company from February 2006 to May 2007. From May 2007 until December 2007, Andrews served as CEO. He was named President in December 2007. On September 19, 2008, SLM announced that Andrews would be leaving the Company effective September 30, 2008.

33. Defendants Lord and Andrews (the "Individual Defendants"), because of their positions with the Company, possessed the power and authority to control the contents of Sallie Mae's quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. They were provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions with the Company and their access to material non-public information available to them but not to the public, the Individual Defendants knew that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations being made were then materially false and misleading. The Individual Defendants are liable for the false statements pleaded herein.

34. The Individual Defendants and Sallie Mae are sometimes collectively referred to herein as “Defendants”.

35. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the materially false and misleading information conveyed in Sallie Mae’s public filings, press releases and other group-published documents addressed herein reflect their collective work. Each of the Individual Defendants, by virtue of his position with the Company, and as more particularly discussed below, was a corporate insider and directly participated in the day-to-day operations and affairs of the Company at the highest levels and was privy to confidential proprietary information regarding the Company and its business operations, products, growth, financial statements and financial condition, as alleged herein. During the Class Period, the Individual Defendants were involved in the drafting, preparation, review and/or dissemination of the various public, shareholder and investor reports and other communications, including investor conference calls, which contained the materially false and misleading information alleged herein and were aware of, or recklessly disregarded, that materially false and misleading statements were being issued regarding the Company, and approved or ratified these statements, in violation of the federal securities laws. The Individual Defendants signed numerous materially false statements filed with the SEC.

36. During the Class Period, the Individual Defendants participated in preparing, reviewing, approving and/or certifying consolidated financial statements for Sallie Mae that purported to conform with applicable regulatory requirements and GAAP. These financial statements were filed with the SEC, and disseminated to the public, through inter alia, Company press releases, quarterly reports on Forms 10-Q and annual reports on Forms 10-K, and in other communications with investors, credit rating agencies, bank lenders and securities analysts. The

financial information contained therein misrepresented that Sallie Mae's financial statements were accurate.

37. The Individual Defendants were aware of, or recklessly disregarded, the misstatements contained in the SEC filings, press releases and other public statements complained of herein, and their materially false and misleading nature. Because of their Board membership and/or executive and managerial positions, each of the Individual Defendants had access to the materially adverse undisclosed information about Sallie Mae and its financial condition and performance as particularized herein, and knew or recklessly disregarded that these adverse facts rendered the representations made by them or Sallie Mae materially false and misleading.

38. As officers and/or directors and controlling persons of a publicly held company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act and traded on the NYSE, and governed by the provisions of the federal securities laws, the Individual Defendants each had a duty to disseminate promptly accurate and truthful information with respect to the Company's financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, and to correct any previously issued statements that were known to have become materially false or misleading, so that the market price of the Company's publicly traded securities would be based upon truthful and accurate information, but failed to do so.

#### **IV. CLASS ACTION ALLEGATIONS**

39. Plaintiff brings this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3) on behalf of all persons and entities who purchased or otherwise acquired Sallie Mae common stock (the "Class") between January 18, 2007 and January 23,

2008, inclusive (the "Class Period"). Excluded from the Class are Sallie Mae, the Individual Defendants, any member of the families of the Individual Defendants, any entity in which any Individual Defendant has a controlling interest, any other Defendant or any entity which is a parent or subsidiary of, or which is controlled by, such Defendant, and the officers, directors, employees, affiliates, legal representatives, heirs, predecessors, successors and assigns of Defendants.

40. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, SLM's common stock was actively traded on the NYSE in a well-developed and efficient market. While the exact number of Class members is unknown to Plaintiff at this time, and can only be ascertained through appropriate discovery, Plaintiff believes there are, at a minimum hundreds if not thousands of members of the Class. Sallie Mae has over 466 million shares of stock outstanding. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court.

41. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class which predominate over questions which may affect individual Class members include:

- a. whether the 1934 Act was violated by Defendants;
- b. whether Defendants omitted and/or misrepresented material facts;
- c. whether Defendants' statements omitted material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading;
- d. whether Defendants knew or deliberately disregarded that their statements were false and misleading;

e. whether the price of Sallie Mae's common stock was artificially inflated;  
and

f. the extent of damage sustained by Class members and the appropriate measure of damages.

42. Plaintiff's claims are typical of those of the Class because Plaintiff and the Class sustained damages from Defendants' wrongful conduct.

43. Plaintiff will adequately protect the interests of the Class and has retained counsel who are experienced in class action securities litigation. Plaintiff has no interests which conflict with those of the Class.

44. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

## V. FRAUDULENT SCHEME AND COURSE OF BUSINESS

### A. Background

45. Sallie Mae, through its subsidiaries, provides education finance in the United States. It originates and holds student loans by providing funding, delivery, and servicing support for education loans through its participation in FFELP and through offering non-federally guaranteed Private Education Loans. The federally guaranteed student loans offered by Sallie Mae were created by the Higher Education Act of 1965 ("HEA") (Pub. L. No. 89-329). The HEA was designed "to strengthen the educational resources to our colleges and universities and to provide financial assistance for students in postsecondary and higher education." Student loan programs such as FFELP and the loans originated under this program were created under Title IV of the HEA.

46. The Company primarily markets its FFELP loans and PELs through on-campus financial aid offices. It also engages in a debt management operations business, which provides a range of accounts receivable and collections services, including student loan default-aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, and accounts receivable management and collection for purchased portfolios of receivables. In addition, the Company purchases and manages sub-performing and non-performing mortgage loans. Further, it provides a range of other financial services, processing capabilities, and information technology to educational institutions, lenders, students and their families, and guarantee agencies.

47. Sallie Mae was originally created as a government sponsored enterprise in 1972. The Company began to privatize its operations in 1997 and the process was completed at the end of 2004 when it terminated its ties to the federal government. In 1996, Sallie Mae began to move away from its original model of providing federally guaranteed loans to students.

48. In 1998, SLM again substantially expanded its portfolio of private loans. SLM Financial, a wholly owned subsidiary of SLM, began to offer private loans called Education Capital Professional loans, directly to borrowers who were enrolled in career training courses or a distance learning school, attending two-year or four-year proprietary school, attending a four-year college less than half-time or who needed a computer loan.

49. In the third quarter of 2004, SLM continued its expansion into the PELs market by creating Tuition Answer loans. The Tuition Answer loans were marketed by SLM directly to students through direct mail campaigns and web-based initiatives. These loans were made by a lender-partner and then sold to the Company. By December 31, 2005, SLM had \$877 million Tuition Answer loans outstanding of the \$6.5 billion in private loans awarded by the Company.

50. During the Class Period, PELs were offered by Sallie Mae to borrowers who were attending schools that provided traditional higher education, undergraduate and graduate degrees, and alternative education, such as information technology, cosmetology, mechanics, medical, dental, lab, culinary, and broadcasting. SLM also originated and purchased PELs marketed by its SLM Financial subsidiary to career training, technical, and trade schools, and tutorial and learning centers. These loans were primarily made at schools that are not eligible for Title IV loans. Traditional higher education PELs have repayment terms that are similar to FFELP loans, with repayment beginning after the borrower leaves school. Generally, repayment for alternative education and career training loans begins immediately.

**B. SLM's Manipulation of Forbearances to Hide the Company's Delinquency Crisis**

51. Late payments on loans were categorized in 30 day delinquency "buckets", with the final bucket being 180-212 days delinquent. After 212 days, a loan was to be written off. SLM established forbearance policies for the PELs, whereby a borrower, who was 212 days late, could delay making loan payments and the Company would abstain from collection activity on the account. Forbearance enabled SLM to avoid the negative financial consequence of categorizing a loan as delinquent. An over 212 day delinquent loan would have had to have been charged off. Rather than negatively affect its reported financial position by truthfully reflecting necessary charge-offs, SLM's corporate policy was to convince borrowers to accept forbearance. As will be described in greater detail below, confidential witnesses have explained that Sallie Mae, without regard for the borrowers' ability to repay the loan, frequently placed borrowers into forbearance without the borrower's consent and often pressured borrowers to enter forbearance.

52. During the forbearance period, interest that the borrower would have paid was generally capitalized as principal, thus increasing the loan amount and making it more onerous

for the borrower to ultimately repay. The borrower's account was removed from delinquency status if payments were past due, as was the case in most forbearance situations. Borrowers could apply for forbearance multiple times. The account was considered current once the borrower exited forbearance and entered repayment. If the loan became past due again, any prior delinquency period was ignored and the loan progressed through the delinquency categories regardless of any prior delinquency period. Such loans became new again and would not be written off under Sallie Mae accounting policy until a full 212 days in delinquency, unless another forbearance period was granted and the cycle began again.

53. When a loan became delinquent or entered forbearance, it had a direct impact on Sallie Mae's balance sheet. Sallie Mae had to adjust its loan loss reserves based on the contingency that a loan would not be repaid. The Company refers to its loan loss reserve as an "Allowance for Loan Losses." This reserve represents a contingency that loan accounts may not be fully collectible. A provision for loan losses is the deduction that is taken to current period income to increase the reserve. Generally, under Sallie Mae's accounting policy, loan principal is charged off against the reserve when a loan exceeds 212 days (approximately 7 months) delinquency.

54. Sallie Mae used forbearance as a means to reduce delinquencies and avoid charge-offs on the increasing number of loans that were past due with no documented basis for future repayment and to avoid charging off those loans. Charge-offs would have materially negatively affected SLM's balance sheet and required additional provisions for loan losses that would have reduced current income. On-balance-sheet forbearances (loans that constitute assets owned by Sallie Mae and therefore reside on the Consolidated Balance Sheet) in Sallie Mae's PEL portfolio increased 38%, 10%, 29%, and 9% each quarter, respectively, between December

31, 2006 and December 31, 2007. As of December 31, 2006, Sallie Mae's PEL portfolio had approximately \$1.2 billion in forbearance representing 9% of total loans in repayment and forbearance. This amount and percentage increased during 2007 and grew to \$2.4 billion and 14%, respectively, as of December 31, 2007.

55. The principal amount of on-balance-sheet PELs in forbearance as a percentage of the principal amount of loans classified as delinquent (31 days or greater) was 56%, 81%, 87%, 99% and 120% as of December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007 and December 31, 2007, respectively. Off-balance-sheet PELs (loans that constitute assets not owned by Sallie Mae, i.e, sold in securitizations and therefore are not included on Sallie Mae's Consolidated Balance Sheet) in forbearance as a percentage of loans classified as delinquent (31 days or greater) was 220%, 317%, 320%, 330% and 340% as of December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007 and December 31, 2007, respectively. Total managed PELs in forbearance as a percentage of loans classified as delinquent (31 days or greater) was 117%, 169%, 170%, 179%, and 195% as of December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007 and December 31, 2007, respectively. In short, during the Class Period, SLM's higher-risk PELs in forbearance grew at a consistently greater rate than loans in delinquency.

56. Assuming Sallie Mae's reported forbearance remained consistent with the average reported forbearances at year-end 2004, 2005, and 2006, and therefore additional amounts reported in forbearance ultimately should have stayed in the various delinquency categories, the following upward adjustments to reported delinquent loans and reported delinquencies as a percentage of Sallie Mae's PELs in repayment would result:

**PEL Managed**

	12/31/2006			3/31/2007			6/30/2007			9/30/2007			12/31/2007		
	As Reported	Adj.	% Inc.												
<b>Delinquent Loans</b>	1,010	1,057	5%	971	1,403	44%	965	1,335	38%	1,089	1,666	53%	1,227	2,169	77%
<b>Total Private Education Loans in repayment</b>	11,643	11,690	0%	11,706	12,138	4%	12,840	13,210	3%	12,799	13,376	5%	14,866	15,808	6%
<b>Delinquencies as a percentage of Private Education Loans in repayment</b>	8.7%	9.0%	4%	8.3%	11.6%	39%	7.5%	10.1%	34%	8.5%	12.5%	46%	8.3%	13.7%	66%

**1. Forbearance Was Systematically Granted to or Imposed on Borrowers Regardless of Qualification**

57. SLM collection employees were generally divided between the Private Credit department servicing PELs and those servicing federally subsidized loans such as FFELP. SLM operated multiple call centers around the country, which served multiple purposes. During the Class Period, a key purpose of the centers was to encourage forbearance for PEL borrowers.

58. Collections personnel at SLM's call centers handled forbearance calls and each center had numerous employees. While the titles of the collections personnel varied somewhat from one geographic area to another, the collections centers' hierarchy was essentially the same. The persons who made and received calls to and from borrowers were referred to with such titles as collections "specialists" and "representatives." They reported to a supervisor who, in turn, reported to a manager.

59. In the Las Vegas call center, for example, an automated dialing system was used which arranged calls to debtors by their length of delinquency (30, 60, 90 or over 180 days). (CW 1)<sup>2</sup> (a former SLM employee in the Las Vegas Debt Prevention Department from September 2006 through April 2007 and whose responsibility it was to call borrowers with past due accounts). As the SLM employee logged on to the computer system, the automatic dialer would connect the SLM employee to a phone number and the borrower's account information would be displayed on the screen. This automated dialing system or a similar one was also used in the Mt. Laurel, New Jersey; the Fishers, Indiana; Muncie, Indiana; and Castleton, Indiana facilities. (CW 2) (a former SLM collections agent in the Mt. Laurel, New Jersey facility from November 2007 until May 2008); (CW 3) (a former SLM Claims Aversion Specialist, in Fishers,

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<sup>2</sup> Confidential Witness is hereinafter referred to as "CW\_\_".

Indiana, and Castleton, Indiana facilities from 1996 to 2005 for FFELP loans and from 2005 to January 2008 for PELs).

60. The SLM collections employees were systematically instructed to discuss with the delinquent PEL borrowers the options for dealing with their past-due loans. Based on information provided by former employees of SLM that worked in collection centers, although procedures varied a bit at different times and in different facilities, during the Class Period SLM collection policy was consistent in encouraging PEL collection employees to move past-due loans into forbearance whenever it appeared that payment was not forthcoming. SLM did anything it could to avoid charging-off a loan. In fact, according to CW 4 (a former SLM collector at the Las Vegas, Nevada site from August 2006 to January 2008), CW 5 (a former SLM Muncie, Indiana Customer Service Representative from January to June 2007 in the Private Credit Department), CW 6 (a former SLM Senior Recovery Investigator in the Marlton, New Jersey facility from November 2004 to May 2008 who handled incoming and outgoing Private Credit Loan collections for borrowers who were 180-211 days delinquent); the primary solution offered for a delinquent loan was forbearance. As CW 3 described it, a loan payment and forbearance were the sole options available to a PEL borrower. The sole criterion a borrower had to meet in order to qualify for forbearance was to have forbearance time available. CW 6; CW 3; CW 7 (a former SLM employee in the Fishers, Indiana Call Center from 2005 through 2008, as Federal Collections Skip Tracer and Team Leader who also handled PELs).

61. According to CW 1 and CW 8 (a former SLM employee at the Las Vegas, Nevada call center from 2003 through late 2006 as a Collections Representative, Collections Specialist, and then a Private Credit Team Leader), if the borrower wanted forbearance, an SLM prescribed script was read to the borrower. The primary solution offered, so long as the computer

system showed that the borrower had permitted forbearance time remaining available (normally, up to six months per forbearance and 24 months for the life of the loan), forbearance could be granted. (CW 3; CW 6; CW 7; CW 9 (a former SLM Private Education Loan Collection Specialist in the Marlton, New Jersey office from 2003 through May 2008 on the team handling collections from borrowers who were 91 to 120 days delinquent); and CW 10 (a former SLM Claims Aversion Representative in the Fishers, Indiana facility from July 2007 to June 2008)). The supervisor simply confirmed that the script had been read and that the borrower had forbearance time available, and then forbearance was approved. (CW 1).

62. CW 7 described the process. CW 7 would determine whether the borrower had forbearance time available and inform the borrower of the number of days the borrower was late in making the loan payments. CW 7 would then ask the borrower how the borrower would like to make payment. When the borrower said they could not make a payment, the borrower would be asked why. CW 7 would not input this reason into the computer because the only criteria for granting forbearance was the amount of forbearance time remaining for the loan. CW 7 noted that the maximum forbearance time on a loan was 24 months.

63. No inquiry was made by either the collections representative or the supervisor about the borrowers' ability to repay the loan (CW 1, CW 4, CW 3). FICO credit quality scores were not checked by the call center employees when granting forbearance. (CW 3). In the Muncie facility, supervisor consent was not necessary for a customer service representative to grant forbearance. (CW 5). While the borrower had to state that they were undergoing some sort of hardship, e.g. unemployment or illness, the borrower was not subjected to any financial or other scrutiny. (CW 9).

64. CW 10 confirmed that if a borrower could not make a payment for a delinquent loan to bring the account current, the borrower was urged to accept forbearance. CW 10 was not required to obtain supervisor approval for the forbearance. CW 10 said that collectors had to really push forbearance on the borrowers. If a borrower refused the forbearance option, the borrower could be subjected to a supervisor "Talk Off." (CW 10). The supervisor would speak on the phone with the borrower and threaten to escalate default proceedings against the borrower and ruin the borrower's credit if the borrower did not consent to the forbearance immediately. (CW 10).

65. Some borrowers would not agree to forbearance until the terms of the forbearance were sent to them in writing. (CW 10). However, these borrowers would still be placed into forbearance without ever being sent the written terms. These borrowers would call the facility and demand to be taken out of forbearance because they had never received the written terms and had never consented to the forbearance. (CW 10). These demands were refused because SLM agents and supervisors would insist that the borrower had agreed to forbearance. (CW 10).

66. CW 10 believed that 24 months was the maximum amount of forbearance time per loan. Despite this limit, CW 10 recalled frequently seeing accounts with significantly more time than this limit. For example, CW 10 recalled seeing an account with 88 months of forbearance.

67. Even for these borrowers who were six to seven months delinquent, the Call Center employees were not required to inquire into or confirm the borrowers' ability to make the next payment. CW 6 and CW 9 said that the SLM employee simply asked why the account was delinquent (e.g. unemployment or reduced income) and the reason was entered into the system without confirmation or question. The Call Center employee then sent the borrower a form, via

U.S. mail or e-mail, which the borrower was required to sign, date, and return. Upon the granting of forbearance, the loan is moved out of the delinquency category. As soon as a borrower made their first payment, SLM deemed the loan current.

68. CW 6 confirmed that even for SLM's tardiest and most at risk borrowers, the only criteria for forbearance was the amount of forbearance time available to the borrower; not FICO scores or other such qualitative information. The procedure was the same for all borrowers and in all locations. (CW 3; CW 4; CW 7; CW 9; CW 10).

69. A \$50 per loan transaction fee was the only payment required for the borrower to obtain forbearance. Some supervisors would waive this fee to secure the forbearance. (CW 10). Forbearance was so liberally used that SLM even had a policy that once forbearance had been obtained three times and \$150 in associated fees were paid, the fee was waived for future forbearances granted. (CW 4). Some borrowers had more than one loan with SLM and were permitted to obtain forbearances on more than one loan at a time. (CW 5).

**2. Collections Personnel Were Generously Compensated For Reducing Delinquency by Granting Forbearance**

70. Each call center employee had to meet a quota to receive a bonus. The bonus formula was based on the amount of the delinquency eliminated as a result of the forbearance. For example, if a borrower who owed \$50,000 was put into forbearance, the SLM employee would receive a greater bonus than for granting forbearance to a borrower who owed \$30,000. (CW 1).

71. CW 11, (a former Niles, Illinois Training Development Specialist for Arrow Financial Services (a third-party collection agency purchased by SLM in late 2004) from September 2007 through May 2008), said that the bonus structure in Muncie, Indiana; Las Vegas, Nevada; and Niles, Illinois permitted \$3,000 - 5,000 per month bonus checks for meeting

goals, and that the goals were fairly easy to achieve because SLM gave credit for the entire bonus balance of the loans that became current by virtue of granting forbearance.

72. The SLM collection personnel felt uncomfortable due to what they viewed as assisting people to dig themselves further into debt, but the supervisors made clear that forbearance was to be pushed and the compensation packages reinforced that. (CW 5). In fact, forbearance was SLM's training focus. According to CW 12 (a former SLM collection specialist in the Las Vegas, Nevada facility from May 2007 through April 2008), Sallie Mae taught its collection agents how to grant forbearance before it taught them how to collect on the loans. During CW 12's two week training period, SLM emphasized that forbearance was a way to solve delinquencies. CW 12 also recalled that much of the information on the loan documents was incomplete, including basic information such as mailing addresses.

73. Since SLM collections personnel received sizeable bonuses based on the amount of forbearance they granted, especially when compared to their hourly pay, they were intent upon granting forbearance. For example, CW 5 said that his base salary was \$8 per hour, but the bulk of his pay came from his bonus. CW 5 and the others in his department received individual and departmental bonuses based upon the dollar amount of the loans they placed in forbearance. In peak months, CW 5 earned \$2,900 in bonuses.

74. CW 3 chose to become a PEL collector to make more money because the bonus pay for moving PEL loans out of delinquency into forbearance made that job more lucrative than working on federal loans. CW 3 said there was extreme pressure to perform as a PEL collector. Bonuses depended on reaching and exceeding the dollar goals assigned. Goals were measured by the dollar value of the loans brought from late to current with a typical daily goal of \$1

million. If a collector failed to meet the goal, the collector was “written up” and terminated after three such write-ups. (CW 3).

75. During a visit to the Muncie facility in the Spring 2007, Defendants Lord and Andrews told SLM employees they were doing well. (CW 13) (a former SLM collector from 2002 to 2004 and Quality Assurance Analyst from 2004 to July 2006 in the Las Vegas, Nevada facility and then a Quality Assurance Analyst in the Muncie, Indiana facility from July 2006 until July 2008). This confirmed statements made by Muncie management in 2007 that the collections employees were setting record profits, according to CW 13 who said that the Muncie facility opened with 30 private loan credit collections agents, grew very quickly, hired about 400 people by the end of 2006 and later peaked at 548. This contradicts Defendants’ representation that there were serious operational problems at this new Muncie facility that suppressed collections through the first two quarters of 2007.

**3. Collections Managers Systematically Monitored the Results of the Forbearance Process Carried Out By Their Teams**

76. Collections managers met monthly to discuss the statistics from each department, including the Private Credit department (CW 8, CW 6). The Team Leaders covered each collection statistic, i.e. the number and dollar volume of forbearance and reduction in rolling forward delinquencies at the monthly meetings (CW 8). These statistics were the performance goals on which the call center’s employees were based. (CW 8). Each team was informed of its performance and its goals were set. (CW 6). Team members could track their performance via daily computer inputs of the volume of loans brought current (CW 6). CW 9’s supervisor provided CW 9 with a daily performance report that reflected the amount of loans CW 9 brought to current status. CW 7 attended a team meeting during the second week of each month where the performance was reviewed and new team and individual goals were provided.

77. The Las Vegas Call Center held quarterly meetings at which members of executive management spoke (including John F. Worley (SLM's Executive Vice President of Debt Management Operations), Lord and Thomas J. Fitzpatrick (SLM CEO and Vice Chairman until May 2007). (CW 8).

78. According to CW 8, during a training meeting in the second half of 2006, trainer Ed Hahn provided information about demographic studies concerning the loan repayment rates for graduates from various institutions and about employment rates for various degree programs.

79. That SLM corporate policy with respect to forbearance was followed across the country at its various facilities demonstrate that SLM executive management, including Defendants, approved and encouraged the liberal granting of forbearance. This practice continued until 2008 when SLM was forced to take a \$575 million provision for loan loss reserves (on a GAAP basis) in the fourth quarter of 2007 and tighten the standards for granting forbearance.

4. **Extended Forbearance Terms in 2007 and Tightening in Early 2008**

80. Confidential witnesses confirmed that it was easier to grant forbearance in 2006 and 2007 than it had been previously. CW 6 said that from early 2007 to December 2007, CW 6 was able to offer 7 months of forbearance rather than 6 months, for an 8 month overdue account that should have been written off under the Company's 212 day default policy. This new SLM policy was communicated to SLM's employees via email, together with an accompanying new forbearance form. (CW 9). As a result, in the 211 day group, only a single payment was needed to bring an 8 month delinquent account current. The borrowers' ability to make the next payments was not an item a call center employee was required to confirm. SLM's internal

guidelines described above remained unchanged during the Class Period. Confidential Witnesses reported that the guidelines became stricter in 2008.

**5. There Were No Substantial Operational Problems at the Newer Muncie, Indiana Facility to Justify SLM's Representations that the Resolution of Such Problems Were a Material Reason for Reduced Loan Loss Provisions in the Third Quarter of 2007**

81. CW 13 (a former SLM employee who worked as a collector in the Las Vegas, Nevada call center from 2002 to 2004, and as a Quality Assurance Analyst in Las Vegas from 2004 until 2006 and in the Muncie, Indiana facility from 2006 until July 2008) helped open the Indiana call center and said that the transition from Nevada to Indiana did not create any operational problems. In fact, throughout 2007 and the beginning of 2008, the Muncie facility was setting collection records. (CW 13). These collection records were based on actual collections made as well as accounts that were moved into current status.

82. Others confirm that they were aware of no significant operational difficulties at the Muncie facility. CW 14 (a 23 year veteran of SLM located in Reston, who reported to Somsak Chivavibul, SLM's Senior Vice President, Financial Planning and Analysis) was unaware of any problems with the transfer of the Nevada call center to the Muncie, Indiana facility. CW 13 was aware of no glitches that inhibited collections at the Muncie facility and never heard of a computer issue that interrupted collections at any other collections facility. CW 9 and CW 3 said they were unaware of any computer glitches interfering with the collections process.

83. The above calls into question the veracity of SLM's representations, beginning in late 2006, that increased provisions for loan losses were expected in the first two quarters of 2007 as a result of operational difficulties at the new Muncie collections facility. When, notwithstanding increased delinquencies and loans in forbearance in the third quarter, SLM

increased its loan loss reserves by \$90 million less than the prior quarter's provision, Defendant Andrews again cited the Muncie facility as justification for the diminished provision. As discussed herein, these statements were materially false and misleading.

**C. Sallie Mae Failed to Adhere to Proper Underwriting Practices in its Student Loan Originations**

84. According to CW 15 (a former SLM Operations Supervisor, whose duties included setting up financial aid profiles for schools, lenders and guarantors, from October 2003 to April 2007 and a Senior Policy Analyst from April 2007 to June 2008 in Fishers, Indiana), Sallie Mae's credit criteria parameters, which determined whether a high-risk loan would be approved, were very broad. These high-risk loans included Career Training Loans<sup>3</sup> and loans that were offered by SLM Financial. (CW 15). CW 15 explained that the Career Training Loans were made to borrowers that had poor credit scores and were often provided without a co-signer. These loans were also provided to borrowers who were attending schools that had high cohort default rates<sup>4</sup> which, according to CW 15, indicated that the borrowers were not graduating. SLM, however, continued to make these loans. (CW 15). CW 15 noted that during CW 15's tenure at SLM, the default rates were always high at these schools and that SLM made loans that it should not have granted as early as 2003.

85. Borrowers were assigned to a pricing tier based on their credit score, which was used to determine the amount of fees the borrower would incur. (CW 15). CW 15's staff set up these pricing tiers. CW 15 noted that the credit criterion used to grant a loan was too broad because a person could have a bad credit score and still obtain a loan. CW 15 observed that the

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<sup>3</sup> Career Training Loans are private loans offered by SLM to students attending schools such as technical training schools, trade schools, and online courses.

<sup>4</sup> A cohort default rate is the percentage of a school's borrowers who enter repayment on certain Federal Family Education Loan (FFEL) Program or William D. Ford Federal Direct Loan (Direct Loan) Program loans during a particular federal fiscal year, October 1 to September 30, and default or meet other specified conditions prior to the end of the next fiscal year.

breadth of the pricing tiers was not appropriate and that borrowers with credit scores as low as 300<sup>5</sup> could qualify for a private loan. According to CW 15, Sallie Mae did not ask borrowers to provide verification of their income for private loans.

86. CW 15 noted that SLM had a large financial incentive to generate these loans because the private education loans generated large fees. Many schools, such as University of Phoenix and Corinthian Colleges, had high private credit volume and were top SLM customers. (CW 15). Therefore, these schools obtained the loans they wanted for their students. (CW15).

87. CW 15 also explained that Sallie Mae's underwriting process was automated. A student would apply for a SLM private loan through the school or online. The school would then certify the cost of attendance and submit this information to SLM. Once this information was placed into SLM's system, the loan was either approved or denied by an automated process. However, if a loan was denied, an SLM underwriter could review the credit report and try to resolve the issue with the borrower. (CW 15). There were different ways that a borrower could address the problems that caused the loan to be denied. Until two or three years ago, Sallie Mae allowed borrowers to submit a letter to the Company that explained the problems with their credit report. (CW 15). According to CW 15, this letter was enough to get many loans approved. CW 15 believed that this process allowed borrowers who had previously not been qualified for these loans to obtain approval for loans more easily.

88. CW 16 (a former SLM underwriter of non-traditional loans for SLM Financial in Mt. Laurel, New Jersey from June 2005 to September 2007) was often questioned by the CW's supervisor when CW 16 denied a loan. CW 16 observed that underwriters did not verify

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<sup>5</sup> A credit score is a number that is based on a statistical analysis of a person's credit report and is used to represent the likelihood that the person will pay his or her debts. The best-known and most widely used credit score model is FICO, developed by Fair Isaac Corporation. FICO credit scores range from 300 to 850, representing the lowest and highest levels of borrower creditworthiness

information such as contact references provided by the borrowers. Furthermore, the underwriters were saddled with a daily quota. (CW 16). Under SLM's policies CW 16, had to work on 150 loans a day and approve 50% of these loans. When CW 16 would question a loan application, the CW's supervisor would try to justify approving every loan.

## **VI. DEFENDANTS' FALSE AND MISLEADING STATEMENTS ISSUED DURING THE CLASS PERIOD**

### **A. SLM's January 18, 2007 Form 8-K and Press Release**

89. On January 18, 2007, the Company filed a Form 8-K Report and related press release and financial schedules, announcing the Company's fourth quarter and annual 2006 results. The press release entitled "Sallie Mae's fee-based businesses exceed \$1 billion; managed loans grow 16 percent to \$142 billion," stated in part:

- Loan Purchases Top a Record \$34 Billion
- Fee Income Increases 20 Percent
- Internal Lending Brands' Growth Rate Exceeds 40 Percent

. . . SLM Corporation . . . , commonly known as Sallie Mae, today reported fourth-quarter and full-year 2006 earnings and performance results that include a total managed student loan portfolio of \$142 billion, a 16-percent increase from the year-ago quarter.

*"Core earnings" net income was \$326 million, or \$.74 per diluted share, for the 2006 fourth quarter, compared to \$284 million, or \$.63 per diluted share, in the year-ago quarter. For the full-year 2006, "core earnings" net income was \$1.3 billion, or \$2.83 per diluted share, up from \$1.1 billion, or \$2.51 per diluted share, for 2005. Recognizing stock-based compensation in both the current and year-ago periods and adjusting for one-time items, "core earnings" diluted earnings per share were \$.74 in the fourth quarter 2006, a 16-percent increase from \$.64 in the year-ago quarter, and \$2.79 in 2006, a 17-percent increase from \$2.39 in 2005.*

We delivered a record amount of loans to help students access higher education," said Tim Fitzpatrick, CEO. "The private sector, led by Sallie Mae, continues to provide product, pricing and service innovations that deliver results to 80 percent of colleges and universities in the U.S. and help nearly 6 million

students access college every year.

*. . . Fourth-quarter 2006 GAAP net income was \$18 million, or \$.02 per diluted share, compared to \$431 million, or \$.96 per diluted share, in the year-ago quarter. GAAP net income for 2006 totaled \$1.2 billion, compared to \$1.4 billion in 2005. Included in these GAAP results are pre-tax net losses on derivative and hedging activities of \$(245) million in the fourth-quarter 2006 and \$(339) million year-to-date 2006, compared to pre-tax net gains of \$70 million and \$247 million in the respective year-ago periods. (Emphasis added.)*<sup>6</sup>

90. The financial result schedules accompanying the press release, among other financial data, stated that SLM's loan loss reserves for its private education loan portfolio was \$308 million.

91. This press release was materially false and misleading for the same reasons set forth, *infra*, concerning the SLM 10-K Report for fiscal year end 2006. In particular, the press release concealed that the Company's internal lending brands were growing at a 40% rate because those private education loans were being aggressively marketed and granted to borrowers with weak creditworthiness using lax underwriting practices, and that the PEL portfolio loan loss reserves were far too low due to the extremely high risk of loan losses in that portfolio, which included a rapidly growing amount for non-traditional educational programs.

**B. SLM's 10-K Report for Fiscal Year End ("FYE") 2006**

92. On March 1, 2007, SLM filed its Annual Report on Form 10-K with the SEC for 2006 ("2006 10-K").

93. Defendants Lord and Andrews signed the 2006 10-K for themselves and SLM.

94. As SLM's CFO, Defendant Andrews signed the Sarbanes-Oxley Act of 2002 certification ("SOX Certification") falsely stating that the Company's Form 10-K did not contain

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<sup>6</sup> SLM evaluates the Company's business segments on a basis that differs from Generally Accepted Accounting Principles. SLM refers to management's basis of evaluating the Company's segment results as "core earnings" presentations for each business segment. The Company's "core earnings" performance measures are not defined terms within GAAP and are not comparable to similarly titled measures reported by other companies.

any material misstatements or omit material information, that the report fairly presented, in all material respects, the Company's financial conditions and results of operations, that its internal controls over financial reporting were sufficient to provide reasonable assurance of the reliability of the Company's financial reporting and that SLM's financial statements were prepared in accordance with GAAP.

95. In the 2006 10-K, the Company stated, in relevant part: "Management believes that the allowance for loan losses is appropriate to cover probable losses in the student loan portfolio."

96. This statement was materially false and misleading because, as described herein based on information obtained from confidential witnesses and as later admitted by Defendants, the Company could not claim that it had set an appropriate level of loan loss reserves for PELs. The Company was granting forbearance to borrowers without inquiring into the borrowers' ability to repay the loans. Notwithstanding SLM's lack of the key information necessary, these loans were removed from the delinquency category and, upon their exit from forbearance, were considered current. This manipulation allowed the Company to record a lower reserve for the loans that were granted forbearance than if the loans had remained in the delinquency category. The Company's failure to properly record such reserve hid the deteriorating nature of its PEL portfolio, and in particular, its non-traditional portfolio, from the investing public throughout the Class Period.

97. In the 2006 10-K, the Company claimed:

Toward the end of 2006 and in early 2007, we experienced lower collections resulting in increased levels of charge-off activity in our Private Education Loan portfolio. We believe that this is attributable in some degree to a number of operational challenges at our DMO [Debt Management Operations] in performing pre-default and post-default collections on the Company's Private Education Loan Portfolio. In August 2006, we announced that we intended to

relocate responsibility for certain Private Education Loan collections from our Nevada call center to a new call center in Indiana. This transfer presented us with unexpected operational challenges that resulted in lower collections that have negatively impacted the Private Education Loan portfolio. Management has taken several remedial actions, including transferring experienced collection personnel to the new call center. In addition, the DMO also revised certain procedures, including its use of forbearance, to better optimize our long-term collection strategies. We expect that these developments will result in increased later stage delinquency levels and associated higher charge-offs in the first and perhaps the second quarters of 2007.

98. Throughout the Class Period, the Company made false and misleading statements whereby it claimed that the transfer of PEL collections from a Nevada call center to a new Indiana call center had a negative impact on the PEL portfolio. The Company's claim that it faced "operational challenges" is false. As discussed above, throughout 2007 and the beginning of 2008 the Muncie, Indiana facility was setting collection records and was not facing substantial operational challenges. These collection records were based on actual collections that were made, as well as accounts that were moved into current status.

99. These false and misleading statements were repeated in the Company's Form 10-Q filed with the SEC for the quarterly period ended March 31, 2007, the 10-Q for quarterly period ended June 30, 2007, and the 10-Q for quarterly period ended September 30, 2007.

100. The Company claimed, in the 2006 10-K, that it had adequate underwriting standards for its PELs. SLM stated, in relevant part:

Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. The Company manages this additional risk through industry-tested loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate the Company for the higher risk.

101. This statement was materially false and misleading because, as Defendant Lord later admitted after the end of the Class Period, SLM was not following appropriate underwriting standards, but had instead, as early as 2004, "started lending with less selectivity", granting

“every loan to every student” and holding “our own view that credit scores are of limited meaning for undergraduates”.

102. In the 2006 10-K, SLM explained its underwriting and forbearance policies for PELs as follows:

***Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies.*** These loans generally supplement federally guaranteed student loans, which are subject to federal lending caps. Private Education Loans are not federally guaranteed or insured against any loss of principal or interest. Traditional student borrowers use the proceeds of these loans to obtain higher education, which increases the likelihood of obtaining employment at higher income levels than would be available without the additional education. As a result, the borrowers’ repayment capability improves between the time the loan is made and the time they enter the post-education work force. We generally allow the loan repayment period on traditional higher education Private Education Loans to begin six months after the borrower leaves school (consistent with our federally regulated FFELP loans). This provides the borrower time after graduation to obtain a job to service the debt. For borrowers that need more time or experience other hardships, we permit additional delays in payment or partial payments (both referred to as forbearances) ***when we believe additional time will improve the borrowers’ ability to repay the loan.*** Forbearance is also granted to borrowers who may experience temporary hardship after entering repayment, ***when we believe that it will increase the likelihood of ultimate collection of the loan. Forbearance can be requested by the borrower or initiated by the Company*** and is granted within established policies that include limits on the number of forbearance months granted consecutively and limits on the total number of forbearance months granted over the life of the loan. In some instances of forbearance, we require good-faith payments or continuing partial payments. Exceptions to forbearance policies are permitted in limited circumstances and only when such exceptions are judged to increase the likelihood of ultimate collection of the loan.

Forbearance does not grant any reduction in the total repayment obligation (principal or interest) but does allow for the temporary cessation of borrower payments (on a prospective and/or retroactive basis) or a reduction in monthly payments for an agreed period of time. The forbearance period extends the original term of the loan. While the loan is in forbearance, interest continues to accrue and is capitalized as principal upon the loan re-entering repayment status. ***Loans exiting forbearance into repayment status are considered current regardless of their previous delinquency status.***

Forbearance is used most heavily immediately after the loan enters repayment. As indicated in the tables below that show the composition and status

of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment, the percentage of loans in forbearance decreases the longer the loans have been in repayment. At December 31, 2006, loans in forbearance as a percentage of loans in repayment and forbearance is 11.7 percent for loans that have been in repayment one to twenty-four months. The percentage drops to 3.4 percent for loans that have been in repayment more than 48 months. The percentage drops to 3.4 percent for loans that have been in repayment more than 48 months. Approximately 76 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. *Forbearance continues to be a positive collection tool for Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. We consider the potential impact of forbearance in the determination of the loan loss reserves.* (Emphasis added.)

103. The above-cited statement that “Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies” was materially false and misleading for the reasons set forth in paragraph 101 above.

104. As discussed hereinabove, based upon information obtained from confidential witnesses and as later admitted by Defendants, the statements in the above-cited passage relating to forbearance, are also materially false and misleading. Having failed to inquire into the borrowers’ ability to repay, the Company did not have a basis on which to claim that by granting forbearance, it would improve the borrowers’ ability to repay the loan. The Company also failed to disclose that it would place loans into forbearance without a borrower’s consent or that the Company would refuse to remove that borrower’s loans from forbearance. The Company’s statements that it would consider the potential impact of forbearance in its determination of loan loss reserves is likewise materially false and misleading because the Company was placing loans in forbearance without borrower consent and without proper investigation into the borrower’s ability to repay the loans. Therefore, the Company was creating a lower loan reserve than it

should have and this became apparent in the fourth quarter of 2007 when the Company had to increase its loan loss provision by \$575 million.

105. The above-cited passage does not separately address the non-traditional private loan portfolio, and thereby fails to reveal the increasing risks in the much more fragile non-traditional loans. Indeed, it is not until the end of the Class Period, that Defendants acknowledge that there was a unique non-traditional portfolio with far higher risks than other PELs.

**C. The April 24, 2007 Form 8-K And Press Release**

106. On April 24, 2007, the Company filed a Form 8-K with the SEC, signed by Defendant Andrews, in which the Company announced its financial results for the first quarter of 2007. The Company issued a press release with respect to its first quarter earnings entitled "SLM Corporation's portfolio of managed loans grows 18 percent in first-quarter 2007." The release stated in part:

- Loan Purchases Up 45 Percent
- Internal Lending Brand Originations Increase 35 Percent
- Direct-to-Consumer Private Education Loans Increase 64 Percent

. . . SLM Corporation. . . , commonly known as Sallie Mae, today reported first-quarter 2007 earnings and performance results that include an 18-percent increase in the managed student loan portfolio to \$150 billion from the year-ago quarter's \$127 billion. Also during the quarter, the company originated \$4.8 billion through its internal lending brands, a 35-percent increase over the year-ago period.

The company purchased \$11.6 billion in education loans during the first-quarter 2007, a 45-percent increase from the year-ago period. Also during the 2007 first quarter, the company originated \$8.0 billion in preferred-channel loans. Approximately 60 percent of all preferred-channel loans originated in the first quarter 2007 were originated by the company's internal lending brands, compared to 47 percent in the year ago period. Preferred-channel loan originations include loans originated by the company's internal lending brands and external lending partners.

Private education loan originations, a segment of preferred-channel originations, were \$2.4 billion, and included more than \$241 million of direct-to-consumer loans, a 64-percent increase from \$147 million of private education loans originated through this channel in the year-ago quarter.

Sallie Mae reported first-quarter 2007 GAAP net income of \$116 million, or \$.26 per diluted share, compared to \$152 million, or \$.34 per diluted share, in the year-ago period. Included in these GAAP results are pre-tax losses on derivative and hedging activities of \$(357) million, compared to \$(87) million in the year-ago quarter, servicing and securitization revenue of \$252 million, compared to \$99 million in the year-ago period, and a provision for losses of \$150 million, compared to \$60 million in the year-ago period.

“Core earnings” net income for the quarter was \$251 million, or \$.57 per diluted share, compared to \$287 million, or \$.65 per diluted share in the year-ago quarter. These results include a provision for losses of \$199 million in the first-quarter 2007, compared to \$75 million in the first-quarter 2006. Annualized net charge-offs as a percentage of average private education loans in repayment were 3.4 percent in the first quarter of 2007, compared to 1.3 percent in the year-ago period.

107. The foregoing Form 8-K and SLM press release were materially false and misleading for the reasons set forth *infra*, concerning the falsity of the SLM Form 10-Q for the quarter ended March 31, 2007. In particular, the press release conceals the fact that the provision for loan losses of \$199 million was materially understated because the 64% growth of PELs was, in part, achieved through lax underwriting procedures and included a substantial quantity of exceptionally high risk non-traditional loans. Further, the reported 3.4% PELs charge-off rate was false because forbearance was being used improperly to remove large amounts of bad loans from delinquency.

**D. SLM's Form 10-Q for the Quarter Ended March 31, 2007**

108. May 10, 2007, Sallie Mae filed its quarterly report on Form 10-Q with the SEC which Defendant Andrews signed.

109. As Sallie Mae's CFO, Defendant Andrews also signed the SOX Certification falsely stating that the Company's 10-Q did not contain any material misstatements or omit

material information, that the report fairly presented in all material respects the Company's financial condition and results of operations and that its internal controls over financial reporting were sufficient to provide reasonable assurance of the reliability of the Company's financial reporting and that SLM's financial statements were prepared in accordance with GAAP.

110. In the 10-Q, the Company stated, in relevant part: "The Company believes that the allowance for student loan losses is appropriate to cover probable losses in the student loan portfolios."

111. This statement was materially false and misleading because as described above based on information obtained from confidential witnesses and as later admitted by Defendants, the Company could not claim that it had set an appropriate level of loan loss reserves for PELs. The Company was granting forbearances to borrowers without inquiring into the borrowers' ability to repay the loans. Notwithstanding SLM's lack of the key information necessary, these loans were removed from the delinquency category and, upon their exit from forbearance, were considered current. This manipulation allowed the Company to record a lower reserve for the loans that were granted forbearance than if the loans had remained in the delinquency category. The Company's failure to properly record such reserve hid the deteriorating nature of its PEL portfolio and, in particular, its non-traditional portfolio, from the investing public throughout the Class Period.

112. The Company also claimed, in this Form 10-Q, that it was experiencing collection problems due to the relocation of its PELs collection center from Nevada to Indiana. SLM stated that:

Toward the end of 2006 and in early 2007, we experienced lower collections resulting in increased levels of charge-off activity in our Private Education Loan portfolio. As the portfolio seasons, we expect charge-off rates to increase from the historically low levels experienced in the prior periods.

However, the large increase in the first quarter of 2007 is caused by factors beyond the portfolio seasoning. In the third and fourth quarters of 2006, we encountered a number of operational challenges at our DMO in performing pre-default collections on the Company's Private Education Loan portfolio that contributed to the increase in charge-offs in the first quarter of 2007. In August 2006, we announced that we intended to relocate responsibility for certain Private Education Loan collections from our Nevada call center to a new call center in Indiana. This transfer presented us with unexpected operational challenges that resulted in lower collections that have negatively impacted the Private Education Loan portfolio. Management has taken several remedial actions, including transferring experienced collection personnel to the new call center. ***In addition, the DMO also revised certain procedures, including its use of forbearance, to better optimize our long-term collection strategies.*** These developments resulted in increased later stage delinquency levels and associated higher charges-offs in the first quarter of 2007, and are expected to affect second quarter and to a lesser extent third quarter delinquency and charge-off levels as well. (Emphasis added).

113. These statements were materially false and misleading because, as discussed above, based upon information from confidential witnesses, throughout 2007 and the beginning of 2008, the Muncie facility was setting collection records and was not experiencing substantial operational challenges. The above-cited statements regarding forbearance were materially false and misleading for the reasons set forth herein below.

114. The Company claimed, in the 10-Q, that it had adequate underwriting standards for its PELs, SLM stated, in relevant part:

Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. The Company manages this additional risk through industry-tested loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate the Company for the higher risk.

115. This statement was materially false and misleading because, as Defendant Lord later admitted after the end of the Class Period, SLM was not following appropriate underwriting standards, but had instead, as early as 2004, "started lending with less selectivity", granting "every loan to every student" and holding "our own view that credit scores are of limited meaning for undergraduates".

116. In the 10-Q, SLM explained its underwriting and forbearance policies as follows:

***Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies.*** These loans generally supplement federally guaranteed student loans, which are subject to federal lending caps. Private Education Loans are not federally guaranteed nor insured against any loss of principal or interest. Traditional student borrowers use the proceeds of these loans to obtain higher education, which increases the likelihood of obtaining employment at higher income levels than would be available without the additional education. As a result, the borrowers' repayment capability improves between the time the loan is made and the time they enter the post-education work force. We generally allow the loan repayment period on traditional higher education Private Education Loans to begin six months after the borrower leaves school (consistent with our federally regulated FFELP loans). This provides the borrower time after graduation to obtain a job to service the debt. For borrowers that need more time or experience other hardships, ***we permit additional delays in payment or partial payments (both referred to as forbearances) when we believe additional time will improve the borrower's ability to repay the loan.*** Forbearance is also granted to borrowers who may experience temporary hardship after entering repayment, ***when we believe that it will increase the likelihood of ultimate collection of the loan.*** Such forbearance is granted within established policies that include limits on the number of forbearance months granted consecutively and limits on the total number of forbearance months granted over the life of the loan. In some instances of forbearance, we require good-faith payments or continuing partial payments. Exceptions to forbearance policies are permitted in limited circumstances and only when such exceptions are judged to increase the likelihood of ultimate collection of the loan.

Forbearance does not grant any reduction in the total repayment obligation (principal or interest) but does allow for the temporary cessation of borrower payments (on a prospective and/or retroactive basis) or a reduction in monthly payments for an agreed period of time. The forbearance period extends the original term of the loan. While the loan is in forbearance, interest continues to accrue and is capitalized as principal upon the loan re-entering repayment status. ***Loans exiting forbearance into repayment status are considered current regardless of their previous delinquency status.***

Forbearance is used most heavily immediately after the loan enters repayment. As a result, forbearance levels are impacted by the timing of loans entering repayment and are generally at higher levels in the first quarter. As indicated in the tables below that show the composition and status of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment, the percentage of loans in forbearance decreases the longer the loans have been in repayment. At March 31, 2007, loans in forbearance as a percentage

of loans in repayment and forbearance are 16.4 percent for loans that have been in repayment one to twenty-four months. The percentage drops to 3.8 percent for loans that have been in repayment more than 48 months. Approximately 80 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. Forbearance continues to be a positive collection tool for the Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. *We consider the potential impact of forbearance in the determination of the loan loss reserves.* (Emphasis added).

117. The above-cited statement that “Private education loans are made to parent and student borrowers in accordance with our underwriting policies” is materially false and misleading for the same reasons as are the statements in Paragraph 115 above.

118. As discussed above, based upon information obtained from confidential witnesses and as later admitted by Defendants, the statements made in the above-quoted passage regarding forbearance, are materially false and misleading. Having failed to inquire into the borrowers’ ability to repay, the Company did not have a basis on which to claim that, by granting forbearance, it would improve the borrowers’ ability to repay the loan. The Company likewise failed to disclose that it would place loans into forbearance without the borrower’s consent or that the Company would refuse to remove that borrower’s loans from forbearance. The Company’s statements that it would consider the potential impact of forbearance in its determination of loan loss reserves is also materially false and misleading because the Company was placing loans in forbearance without borrower consent and without proper investigation into the borrower’s ability to repay the loans. Therefore, the Company was creating a lower loan loss reserve than it should have and this became apparent in the fourth quarter of 2007 when the Company had to increase its loan loss provision by \$575 million.

119. The above-cited passage is also materially false and misleading because it does not separately address the non-traditional private loan portfolio, and thereby fails to reveal the

increasing risks in the much more fragile non-traditional loans. Indeed, it is not until the end of the Class Period that Defendants acknowledged that there was a unique non-traditional loan portfolio with far higher risks than other PELs.

**E. SLM's Form 8-K Filed July 17, 2007**

120. On July 17, 2007, the Company filed a Form 8-K with the SEC which contained a press release entitled "Sallie Mae's managed loan portfolio grows 18 percent from prior year to \$153 billion in second-quarter; Originations through Company's lending brands grow 39 percent." The release stated in part:

SLM Corporation. . . , commonly known as Sallie Mae, today reported second-quarter 2007 earnings and performance results that include an 18-percent increase in managed student loans from the year-ago quarter, with the company's portfolio topping \$153 billion. Second-quarter 2007 preferred-channel loan originations were \$3.6 billion, and loans originated through the company's internal brands, a segment of total preferred-channel loan originations, grew 39 percent from the year-ago period to \$2.4 billion.

Preferred-channel loan originations include loans originated by the company's internal lending brands and external lending partners. Preferred-channel originations in the first half of 2007 were \$11.6 billion, and internal brands originated \$7.2 billion, or 62 percent, of the total.

"Our loan portfolio continues to register strong growth, and our internal brands are outpacing the market," said C.E. Andrews, chief executive officer. "We are delivering best-in-class products and services to schools, students and families to help them access higher education."

. . . Sallie Mae reported second-quarter 2007 GAAP net income of \$966 million, or \$1.03 per diluted share, compared to \$724 million, or \$1.52 per diluted share, in the year-ago period. Included in these GAAP results are pre-tax gains on derivative and hedging activities of \$822 million in the second-quarter 2007, compared to \$123 million in the year-ago quarter, and a decrease of \$671 million in gains on student loan securitizations. Second-quarter 2007 GAAP diluted earnings per share were reduced by \$1.21 due to the reversal of unrealized gains on dilutive outstanding equity-forward contracts as required by the GAAP diluted earnings per share calculation.

"Core earnings" net income for the second-quarter 2007 was \$189 million, or \$.43 per diluted share, down from \$320 million, or \$.72 per diluted share, in

the year-ago quarter. These second-quarter 2007 results include a provision for losses of \$247 million and \$51 million in expenses related to the company's previously announced acquisition. Annualized net charge-offs as a percentage of average private education loans in repayment were 3.5 percent in the second-quarter 2007, compared to 3.4 percent in the prior quarter. For the first half of 2007, "core earnings" net income was \$440 million, compared to \$607 million in the first half of 2006.

121. The foregoing Form 8-K and SLM press release were materially false and misleading for the reasons set forth, infra, concerning the falsity of the SLM Form 10-Q for the quarter ended June 30, 2007.

**F. SLM's Form 10-Q the Quarter Ended June 30, 2007**

122. On August 7, 2007, Sallie Mae filed its quarterly report on Form 10-Q with the SEC. As Sallie Mae's CEO, Defendant Andrews signed the SOX Certification falsely stating that the Company's 10-Q did not contain any material misstatements or omit material information, that the report fairly presented in all material respects the Company's financial condition and results of operations and that its internal controls over financial reporting were sufficient to provide reasonable assurance of the reliability of the Company's financial reporting and that SLM's financial statements were prepared in accordance with GAAP.

123. In its 10-Q, the Company stated, in relevant part: "The Company believes that the allowance for student loan losses is appropriate to cover probable losses in the student loan portfolios."

124. This statement was materially false and misleading because as described above based on information obtained from confidential witnesses and as later admitted by Defendants, the Company could not claim that it had set an appropriate level of loan loss reserves for PELs. The Company was granting forbearances to borrowers without inquiring into the borrowers' ability to repay the loans. Notwithstanding SLM's lack of the key information necessary, these loans were removed from the delinquency category and upon their exit from forbearance, were

considered current. This manipulation allowed the Company to record a lower reserve for the loans that were granted a forbearance than if the loans had remained in the delinquency category. The Company's failure to properly record such reserve hid the deteriorating nature of its PEL portfolio and, in particular, its non-traditional portfolio, from the investing public throughout the Class Period.

125. The Company also claimed, in the 10-Q, that it was experiencing collection problems. SLM stated, in relevant part:

Net interest income after provisions for loan losses decreased by \$38 million versus the second quarter of 2006. The decrease is due to the year-over-year increase in the provision for Private Education Loan losses of \$80 million, which offset the year-over-year \$42 million increase in net interest income. The decrease in net interest income is also due to \$14 million in interim financing costs (commitment and liquidity fees) associated with the Merger (see "RECENT DEVELOPMENTS — Merger-Related Developments — *Financing Considerations Related to the Transaction*"). ***The increase in the provision predominantly reflects a further seasoning and mix of the portfolio and an increase in delinquencies and charge-offs related in part to operational challenges encountered from a call center move.*** These same factors affecting the provision also have a direct impact on the student loan spread due to the related increase in our estimate of uncollectible accrued interest income. The increase in net interest income is due to a \$29 billion increase in the average balance of on-balance sheet interest earning assets, which was partially offset by a 25 basis point decrease in the net interest margin. The year-over-year decrease in the net interest margin is primarily due to incurring \$14 million in interim financing costs (commitment and liquidity fees) related to the Merger and a decrease in the student loan spread.

Net interest income after provisions for loan losses decreased by \$103 million versus the six months ended June 30, 2006. The decrease is due to the year-over-year increase in the provision for Private Education Loan losses of \$171 million, which offset the year-over-year \$68 million increase in net interest income. ***The increase in the provision predominantly reflects a further seasoning and mix of the portfolio and an increase in delinquencies and charge-offs related in part to operational challenges encountered from a call center move.*** These same factors affecting the provision also have a direct impact on the student loan spread due to the related increase in our estimate of uncollectible accrued interest income. The increase in net interest income is due to a \$25 billion increase in the average balance of on-balance sheet interest earning assets, which was partially offset by a 23 basis point decrease in the net

interest margin. The year-over-year decrease in the net interest margin is primarily due to incurring \$14 million in interim financing costs (commitment and liquidity fees) related to the Merger and a decrease in the student loan spread.

Toward the end of 2006 and through mid-2007, we experienced lower pre-default collections resulting in increased levels of charge-off activity in our Private Education Loan portfolio. As the portfolio seasons and due to shifts in its mix and certain economic factors, we expected and have seen charge-off rates increase from the historically low levels experienced in the prior years. However, the large increase in the first half of 2007 is significantly impacted by additional factors. *Among these factors, in the third and fourth quarters of 2006, we encountered a number of operational challenges at our DMO in performing pre-default collections on our Private Education Loan portfolio. In August 2006, we announced that we intended to relocate responsibility for certain Private Education Loan collections from our Nevada call center to a new call center in Indiana. This transfer presented us with unexpected operational challenges that resulted in lower collections that have negatively impacted the Private Education Loan portfolio. In addition, in late 2006 the DMO also revised certain procedures, including its use of forbearance, to better optimize our long-term collection strategies. These developments have resulted in increased later stage delinquency levels and associated higher charge-offs in the first half of 2007.*

Management has been aggressively remediating these issues beginning with actions in late 2006 and early 2007, such as transferring experienced collection personnel to the new call center and conducting extensive training and monitoring. Beginning late in the second quarter and into the early third quarter of 2007, DMO has also instituted more precise analytic collection strategies and new systematic enhancements to better manage the volume, seasoning and shift in the portfolio mix. Because charge-offs are generally reflective of the collection performance of six or seven months prior to the 212-day charge-off event, the effect of all of these actions will not be fully realized until 2008. Due to the remedial actions in place, we anticipate the negative trends caused by the operational-related issues will steadily improve over the remainder of 2007 and the first half of 2008. (Emphasis added.)

127. These statements were materially false and misleading statements because as discussed above based upon information from confidential witnesses, throughout 2007 and the beginning of 2008, the Muncie facility was setting collection records and was not experiencing substantial operational challenges. The above-cited statements regarding forbearance procedures were false and misleading for the reasons set forth herein below.

128. The Company claimed, in the Form 10-Q, that it had adequate underwriting standards for its Private Education Loans. SLM stated, in relevant part:

Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. The Company manages this additional risk through loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate the Company for the higher risk.

129. These statements were materially false and misleading because, as Defendant Lord later admitted after the end of the Class Period, SLM was not following appropriate underwriting standards, but had instead, as early as 2004, “started lending with less selectivity”, granting “every loan to every student” and holding “our own view that credit scores are of limited meaning for undergraduates”.

130. In the 10-Q, SLM explained its underwriting and forbearance policies as follows:

***Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies.*** These loans generally supplement federally guaranteed student loans, which are subject to federal lending caps. Private Education Loans are not federally guaranteed nor insured against any loss of principal or interest. Traditional student borrowers use the proceeds of these loans to obtain higher education, which increases the likelihood of obtaining employment at higher income levels than would be available without the additional education. As a result, the borrowers’ repayment capability improves between the time the loan is made and the time they enter the post-education work force. We generally allow the loan repayment period on traditional higher education Private Education Loans to begin six months after the borrower leaves school (consistent with our federally regulated FFELP loans). This provides the borrower time after graduation to obtain a job to service the debt. For borrowers that need more time or experience other hardships, we permit additional delays in payment or partial payments (both referred to as forbearances) ***when we believe additional time will improve the borrowers’ ability to repay the loan.*** Forbearance is also granted to borrowers who may experience temporary hardship after entering repayment, ***when we believe that it will increase the likelihood of ultimate collection of the loan.*** Such forbearance is granted within established policies that include limits on the number of forbearance months granted consecutively and limits on the total number of forbearance months granted over the life of the loan. In some instances of forbearance, we require good-faith payments or continuing partial payments. Exceptions to forbearance policies are permitted in limited circumstances and only when such exceptions are judged to increase the likelihood of ultimate collection of the loan.

Forbearance does not grant any reduction in the total repayment obligation (principal or interest) but does allow for the temporary cessation of borrower payments (on a prospective and/or retroactive basis) or a reduction in monthly payments for an agreed period of time. The forbearance period extends the original term of the loan. While the loan is in forbearance, interest continues to accrue and is capitalized as principal upon the loan re-entering repayment status. Loans exiting forbearance into repayment status are considered current regardless of their previous delinquency status.

Forbearance is used most heavily immediately after the loan enters repayment. As a result, forbearance levels are impacted by the timing of loans entering repayment and are generally at higher levels in the first quarter. As indicated in the tables below that show the composition and status of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment, the percentage of loans in forbearance decreases the longer the loans have been in repayment. At June 30, 2007, loans in forbearance as a percentage of loans in repayment and forbearance are 14.0 percent for loans that have been in repayment one to twenty-four months. The percentage drops to 4.4 percent for loans that have been in repayment more than 48 months. Approximately 75 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. Forbearance continues to be a positive collection tool for the Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. We consider the potential impact of forbearance in the determination of the loan loss reserves. (Emphasis added.)

131. The above-cited statement that “Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies” is materially false and misleading for the same reasons as are the statements in Paragraph 129 above.

132. As discussed above, based upon information obtained from confidential witnesses and as later admitted by Defendants, the statements made in the above-quote passage regarding forbearance, are materially false and misleading. Having failed to inquire into the borrowers’ ability to repay, the Company did not have a basis on which to claim that, by granting forbearance, it would improve the borrowers’ ability to repay the loan. The Company also failed to disclose that it would place loans into forbearance without the borrowers’ consent or that the

Company would refuse to remove that borrowers' loans from forbearance. The Company's statements that it would consider the potential impact of forbearance in its determination of loan loss reserves is likewise materially false and misleading because the Company was placing loans in forbearance without borrower consent and without proper investigation into the borrowers' ability to repay the loans. Therefore, the Company was creating a lower loan reserve than it should have and this became apparent in the fourth quarter of 2007 when the Company had to increase its loan loss provision by \$575 million.

133. The above-cited passage does not separately address the non-traditional private loan portfolio, and thereby fails to reveal the increasing risks in the much more fragile non-traditional loans. Indeed, it is not until after the end of the Class Period, that Defendants acknowledge that there was a unique non-traditional loan portfolio with far higher risks than other PELs.

**G. SLM's 10-Q Report for the Quarter Ended September 30, 2007**

134. On November 9, 2007, Sallie Mae filed its quarterly report on Form 10-Q with the SEC. As Sallie Mae's CEO, Defendant Andrews signed the SOX Certification falsely stating that the Company's 10-Q did not contain any material misstatements or omit material information, that the report fairly presented in all material respects the Company's financial condition and result of operations, and that its internal controls over financial reporting were sufficient to provide reasonable assurance of the reliability of the Company's financial reporting and that SLM's financial statements were prepared in accordance with GAAP.

135. In this Form 10-Q, the Company stated, in relevant part: "The Company believes that the allowance for student loan losses is appropriate to cover probable losses inherent in the student loan portfolios."

136. This statement was materially false and misleading because, as described above based on information obtained from confidential witnesses and as later admitted by Defendants, the Company could not claim that it had set an appropriate level of loan loss reserves for PELs. The Company was granting forbearances to borrowers without inquiring into the borrowers' ability to repay the loans. Notwithstanding SLM's lack of the key information necessary, these loans were removed from the delinquency category. This manipulation allowed the Company to record a lower reserve for the loans that were granted a forbearance than if the loans had remained in the delinquency category. The Company's failure to properly record such reserve hid the deteriorating nature of its PEL portfolio and, in particular, its non-traditional portfolio, from the investing public throughout the Class Period.

137. The Company also claimed, in this 10-Q Report, that it was experiencing collection problems. SLM stated, in relevant part:

Net interest income after provisions for loan losses increased by \$28 million versus the third quarter of 2006. The increase was due to the \$103 million increase in net interest income, offset by a \$76 million increase in the provisions for loan losses. The increase in net interest income was primarily due to an increase of \$35 billion in the average balance of on-balance sheet interest earning assets, offset by a decrease in the student loan spread, including the impact of Wholesale Consolidation Loans (see "NET INTEREST INCOME — Student Loan Spread Analysis — *On-Balance Sheet*"). The provisions for Private Education Loan losses and FFELP loan losses increased by \$42 million and \$34 million, respectively, versus the year-ago quarter. ***The increase in the provision for Private Education Loan losses was primarily due to a further seasoning and mix of the portfolio and an increase in delinquencies and charge-offs related in part to operational challenges encountered from a call center move*** (see "LENDING SEGMENT — Allowance for Private Education Loan Losses"). The increase in the provision for FFELP loan losses was primarily due to the repeal of the Exceptional Performer program due to the passage of the College Cost Reduction and Access Act of 2007 on September 27, 2007, which resulted in a higher Risk Sharing percentage for the Company (see "RECENT DEVELOPMENTS — Other Developments — *Exceptional Performer*").

Net interest income after provisions for loan losses decreased by \$74 million versus the nine months ended September 30, 2006. The decrease was due to the year-over-year increase in the provision for loan losses of \$246 million, which offset the year-over-year \$172 million increase in net interest income. The increase in net interest income was primarily due to an increase of \$28 billion in the average balance of on-balance sheet interest earning assets offset by a decrease in the student loan spread, including the impact of Wholesale Consolidation Loans (see "NET INTEREST INCOME — Student Loan Spread Analysis — *On-Balance Sheet*"). The provisions for Private Education Loan losses and FFELP loan losses increased by \$205 million and \$40 million, respectively. *The increase in the provision for Private Education Loan losses was primarily due to a further seasoning and mix of the portfolio and an increase in delinquencies and charge-offs related in part to operational challenges encountered from a call center move* (see "LENDING SEGMENT — Allowance for Private Education Loan Losses").

Toward the end of 2006 and through mid-2007, we experienced lower pre-default collections, resulting in increased levels of charge-off activity in our Private Education Loan portfolio. As this portfolio seasons and due to shifts in its mix and certain economic factors, we expected and have seen charge-off rates increase from the historically low levels experienced in prior years. Additionally, the increase was significantly impacted by other factors. *In the second half of 2006, we relocated responsibility for certain Private Education Loan collections from our Nevada call center to a new call center in Indiana. This transfer presented us with unexpected operational challenges that resulted in lower collections that have negatively impacted the Private Education Loan portfolio. In addition, in late 2006, APG also revised certain procedures, including its use of forbearance, to better optimize our long-term collection strategies. These developments have resulted in increased later stage delinquency levels and associated higher charge-offs.*

We have been aggressively remediating these issues, including transferring experienced collection personnel to the new call center and conducting extensive training and monitoring. Beginning in mid-2007, APG also instituted more precise analytic collection strategies and new systematic enhancements to better manage the challenges posed by the volume, seasoning and shift in the portfolio mix. *Due to the remedial actions in place, we anticipate the negative trends caused by the operational difficulties will improve over the remainder of 2007 and 2008.* (Emphasis added.)

138. These statements were materially false and misleading because, as discussed above based upon information from confidential witnesses, throughout 2007 and the beginning of 2008, the Muncie facility was setting collection records and was not experiencing substantial

operational challenges. The above cited statements regarding forbearance procedures were materially false and misleading for the reasons set forth herein below.

139. The Company claimed in the 10-Q that it had adequate underwriting standards for its Private Education Loans. SLM stated, in relevant part:

Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. The Company manages this additional risk through loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate the Company for the higher risk.

140. These statements were materially false and misleading because, as Defendant Lord later admitted after the end of the Class Period, SLM was not following appropriate underwriting standards, but had instead, as early as 2004, “started lending with less selectivity”, granting “every loan to every student” and holding “our own view that credit scores are of limited meaning for undergraduates”.

141. In the 10-Q, SLM explained its underwriting and forbearance policies as follows:

***Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies.*** These loans generally supplement federally guaranteed student loans, which are subject to federal lending caps. Private Education Loans are not federally guaranteed nor insured against any loss of principal or interest. Traditional student borrowers use the proceeds of these loans to obtain higher education, which increases the likelihood of obtaining employment at higher income levels than would be available without the additional education. As a result, the borrowers’ repayment capability improves between the time the loan is made and the time they enter the post-education work force. We generally allow the loan repayment period on traditional higher education Private Education Loans to begin six months after the borrower leaves school (consistent with our federally regulated FFELP loans). This provides the borrower time after graduation to obtain a job to service the debt. For borrowers that need more time or experience other hardships, we permit additional delays in payment or partial payments (both referred to as forbearances) ***when we believe additional time will improve the borrowers’ ability to repay the loan.*** Forbearance is also granted to borrowers who may experience temporary hardship after entering repayment, ***when we believe that it will increase the likelihood of ultimate collection of the loan.*** Such forbearance is granted within established policies that include limits on the number of forbearance months granted consecutively and limits on the total number of forbearance months granted over

the life of the loan. In some instances of forbearance, we require good-faith payments or continuing partial payments. Exceptions to forbearance policies are permitted in limited circumstances and only when such exceptions are judged to increase the likelihood of ultimate collection of the loan.

Forbearance does not grant any reduction in the total repayment obligation (principal or interest) but does allow for the temporary cessation of borrower payments (on a prospective and/or retroactive basis) or a reduction in monthly payments for an agreed period of time. The forbearance period extends the original term of the loan. While the loan is in forbearance, interest continues to accrue and is capitalized as principal upon the loan re-entering repayment status. Loans exiting forbearance into repayment status are considered current regardless of their previous delinquency status.

Forbearance is used most heavily immediately after the loan enters repayment. As a result, forbearance levels are impacted by the timing of loans entering repayment and are generally at higher levels in the first quarter. As indicated in the tables below that show the composition and status of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment, the percentage of loans in forbearance decreases the longer the loans have been in repayment. At September 30, 2007, loans in forbearance as a percentage of loans in repayment and forbearance are 16.9 percent for loans that have been in repayment one to twenty-four months. The percentage drops to 5.0 percent for loans that have been in repayment more than 48 months. Approximately 77 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. Forbearance continues to be a positive collection tool for the Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. Forbearance policies were tightened in late 2006 and no additional policy changes have taken place to date. The increase in use of forbearance is attributed to improved borrower contact procedures and current economic conditions. Loans in forbearance are reserved commensurate with the default expectation of this specific loan status. (Emphasis added.)

142. The above-cited statement that "Private education loans are made to parent and student borrowers in accordance with our underwriting policies" was materially false and misleading for the reasons set for above in Paragraph 140 above.

143. As discussed above, based upon information obtained from confidential witnesses and as later admitted by Defendants, the statements made in the above-quoted passage

regarding forbearance, are materially false and misleading. Having failed to inquire into the borrowers' ability to repay, the Company did not have a basis on which to claim that, by granting forbearance, it would improve the borrowers' ability to repay the loan. The Company also failed to disclose that it would place loans into forbearance without the borrower's consent or that the Company would refuse to remove that borrower's loans from forbearance. The Company's statements that it would consider the potential impact of forbearance in its determination of loan loss reserves is materially false and misleading because the Company was placing loans into forbearance without borrower consent and without proper investigation into the borrowers' ability to repay the loans. Therefore, the Company was creating a lower loan reserve than it should have and this became apparent in the fourth quarter of 2007 when the Company had to increase its loan loss provision by \$575 million.

144. The above-cited passage does not separately address the non-traditional private loan portfolio, and thereby fails to reveal the increasing risks in the much more fragile non-traditional loans. Indeed, it is not until after the end of the Class Period that Defendants acknowledge that there was a unique non-traditional portfolio with far higher risks than other PELs.

#### **H. October 11, 2007 Third Quarter Earnings Conference Call**

145. Lord, Andrews, and Steve McGarry (SLM Vice President of Investor Relations) hosted SLM's Q3 Earnings Conference Call ("Q3 Call") on October 11, 2007. Andrews explained that SLM was focused on growing the PEL side of its loan business and that the PEL sector "is essential to us," as it constituted "the economic engine on the loan side of the business." With respect to the PEL credit quality, Andrews stated, in relevant part:

.....we have had a rocky year from a credit standpoint in loan loss provision, as you know. *We see the right trends and the right signs occurring there. We*

*actually in the third quarter, our loan loss provision was some \$90 million less than in the second quarter. And we see that the charge-off rates and levels and the delinquency rates are trending in the direction that we had expected.*

I think probably some of you know, but in case you don't, we had a *large operational disruption in our collections side of private credit last fall, and early in 2007*. It created disruption that got us behind in some collection process, and we have continued to try to correct those issues, *and we believe all those changes and the implementation of the impact of those are right on target now*. But it has taken us the better part of this year to get that back on-track. But we are starting to see the results of that now in our delinquency trends and charge-off numbers. *And we expect in the near-term our delinquencies levels and charge-offs to hover around that 3% level*. So that is kind of the portfolio look. (Emphasis added.)

146. These statements were materially false and misleading because, as described above, confidential witnesses explained that SLM did not experience “a large operational disruption” in early 2007.

147. In fact, the Company was suffering serious repayment problems with its PEL portfolio, and in particular the non-traditional loans, that it concealed from the public until after the Class Period. In fact, the Company added \$90 million less to its loan loss reserve in the third quarter than in the previous quarter. Charge-offs and delinquency rates were not, in fact, trending lower than expected. The Company was using forbearance as a means to improperly defer charge-offs and to conceal its true delinquency and charge-off rates, and Defendants were knowingly, or with reckless disregard of the truth, employing baseless estimates of future loan losses, which estimates were tainted by the lax underwriting standards applied to the PEL loan borrowers and the aggressive use of forbearance.

148. Defendants Andrews and Lord also represented that the Company did not expect the number of loans in forbearance to continue to increase. During the Q3 Call, Andrews and Lord were asked, “What do you expect going forward with the forbearance? Do you expect it to keep ticking up like it has been?” Andrews responded, “No, I would not. I think we should see

that it remains reasonably stable. There is some seasonality to it at points in time when loans go into repayment, et cetera, so it does have some seasonality, but it ought to sustain some relative stability to it and we shouldn't see it continually stick up, certainly. And the other thing we look to--." Lord interrupted Andrews and responded "The answer is no." However, by the end of 2007 reported forbearances rose to \$2.391 billion. See chart at paragraph 190, *supra*. Andrews further represented that a reason for higher forbearance in 2007 and in the third quarter was due to "we had done some things last year when we encountered some of those problems [presumably the same problems at the new Muncie facility that purportedly caused loss provisions to be higher than normal in the first half of 2007] we encountered that kind of pushed them down. .... and I think we are returning to something that maybe is a bit more of a normal level."

149. This explanation was false for the same reasons that Defendants' blaming the Muncie facility for increased loan loss provisions was false, i.e. there were no substantial operational problems at that facility.

#### **I. October 11, 2007 8-K Report and Press Release**

150. On October 11, 2007, the Company also filed a report on Form 8-K with the SEC which contained a press release entitled "Sallie Mae Student Loan Originations Increase 13-Percent From Year-Ago Quarter; Managed Student Loan Portfolio Reaches \$160 billion." The release stated in part:

SLM Corporation. . . , commonly known as Sallie Mae, today reported third-quarter 2007 earnings and performance results that include a 13-percent rise in its student loan originations to \$8.9 billion, from the 2006 third quarter's \$7.8 billion. Year-to-date 2007, student loan originations were \$20.5 billion, compared to \$18.6 billion in the same period last year. The company's managed student loan portfolio totaled \$160 billion at the end of the third-quarter 2007.

"Thanks to our industry-leading brand, our scale and efficiencies, and our focus on students and families, we successfully faced a number of challenges this quarter," said C.E. Andrews, chief executive officer. "We have a solid track

record of growing our 'core earnings' through various political, interest rate and economic environments, and the fundamentals of our business point to a bright future for our company."

Sallie Mae reported a third-quarter 2007 GAAP net loss of \$344 million, or \$.85 diluted loss per share, compared to net income of \$263 million, or \$.60 per diluted share, in the year-ago period. Included in these GAAP results are pre-tax losses on derivative and hedging activities of \$487 million in the third-quarter 2007, principally related to the decline in share price during the quarter on the company's equity forward positions.

Third-quarter 2007 "core earnings" net income was \$305 million, or \$.70 per diluted share, before \$46 million, or \$.11 per diluted share, in after-tax reductions to net income from the following non-recurring items: \$28 million related to the recent legislative changes in the FFELP risk-sharing percentage and \$18 million related to the company's previously announced merger agreement. Including these non-recurring items, reported "core earnings" net income was \$259 million, or \$.59 per diluted share.

For the first nine months of 2007, "core earnings" net income was \$699 million, compared to \$927 million in the same period last year.

151. This press release was materially false and misleading for the same reasons set forth above with respect to the Third Quarter Conference Call and Form 10-Q. Further, Defendant Andrews' statement that "We have a solid track record of growing our 'core earnings' through various political, interest rate and economic environments, and the fundamentals of our business point to a bright future for our company" was grossly misleading given that SLM management had approved lax underwriting standards for its highest risk loans and was engaging in practices designed to conceal the rapidly deteriorating value of the Company's portfolio of PEL loans. Plaintiff and other investors were misled by this statement, among the other material misrepresentations and non-disclosures in the press release, concerning the true value of SLM's PEL portfolio, which continued to be a time-bomb that was ticking perilously close to detonation.

**J. The December 12, 2007 Press Release**

152. On December 12, 2007, the Company issued a press release entitled "SLM Corporation Provides Update of Transaction and Financial Outlook." SLM reported that it was "lowering its 2008 core earnings EPS guidance from \$3.25 to a range of \$2.60 to \$2.80 due primarily to increased costs from replacing the company's interim funding facility." The Company reported its expectations that its fourth-quarter core earnings per diluted share would be in the range of \$.52 to \$.57, excluding non-recurring items such as merger-related costs, and that its lower than expected 2007 core earnings were being impacted by funding costs and increased reserves for the FFELP loan portfolio.

153. The December 12 press release stated that "The underlying business drivers for the company are strong and executive management is strategically repositioning certain aspects of the business to allow for maximum growth and earnings opportunities." However, this statement failed to reveal the deteriorating condition of the PEL portfolio, and in particular the non-traditional portion of the PEL loan portfolio, despite the fact that on October 11, 2007, Andrews had identified the PEL as the "economic engine on the loan side of the business". While SLM attributed the adverse effect on core earnings primarily to funding costs and increased reserves for the FFELP portfolio, it failed to address the ever-increasing risks in the inherently speculative non-traditional loans. Indeed, it was not until after the end of the Class Period that Defendants revealed that there was a unique non-traditional loan portfolio with much higher risks than other PEL and FFELP loans.

154. In the press release, the Company also announced that the merger transaction with J.C. Flowers, announced in April 2007, would not proceed, and that SLM had been able to renegotiate the strike and trigger prices with its counterparties on equity forward contracts under which SLM would be obligated to repurchase its shares from the counterparties. As a result of

these transactions, the Company's aggregate position on the equity forward contracts was 48.2 million shares at an average strike price of \$43.93, with trigger prices ranging from \$26.00 to \$19.58.

## VII. THE TRUTH BEGINS TO EMERGE

### A. December 19, 2007 Shareholder Conference Call and Its Aftermath

155. On the morning of December 19, 2007, Defendant Lord, who had recently taken over from Defendant Andrews as CEO of the Company, and Steven McGarry, Vice President of Investor Relations, hosted a Shareholder Conference Call. During the conference call, Defendant Lord made the following statements, among others:

I'm going to mention a few words about my stock sale. My bank sold me out on Friday of 1.2 million shares. I will mention that it's embarrassing and troublesome to me personally. It is not a sign of my disillusionment with the Company; in fact, the exact reverse is the case. It is a short-term cost in my view of my own belief in my company. I suppose you might say, one more victim of an unfinished deal. I can assure you that I'm properly incented to create the earnings growth that is Company has been known for and I have no more margin stock – no more margin.....

We made a decision on the basis of trying to increase market share to – not to knock out our borrower benefits in response to the recent legislation. Original forecast had us knocking borrower benefits out. *There are – and we have moved our private credit provision up a little bit since we have talked to you in October.* Since we talked to you in October, this credit crunch reemerged, and – well, so be it.

*As I said, I don't want to get into FICO scores and basis points. Steve can help you guys with your models with respect to these issues, and he will. Of course, I hear a lot of questions about private credit quality.* I would direct you to our securitization data, which is actually showing mild improvement. At least on a delinquency data versus prior quarters, it seems to be moving in the right direction. I am not the least bit Pollyanna-ish because of those numbers. This is a delicate economic environment; at least it seems to be, so we're watching them very closely. I'm pleased they're going in the right direction, but I also would tell you, we are comparing them to first-half statistics which bear the cost of some operational issues and make it a little bit difficult to fully analyze that data.

*We have analyzed our defaults and we have a highly sophisticated and professional group of collectors in our collection function and they've analyzed these defaults and we are on them. We have moved quickly to cut off those loans – the most difficult loans – at their source, and I believe we have a very good understanding of that. This is a very high priority of mine in my new seat.*

156. These statements reveal to the marketplace that SLM was having problems with the PEL portfolio and that PEL-related defaults had increased. By this time, as Lord acknowledges, “a lot of questions about private credit quality” were being raised in the marketplace.

157. Defendant Lord announced that he would not address various issues of concern to investors and refused to answer analyst questions, directing analysts to call Steve McGarry of Investor Relations in response to a request for financial information.

158. Because new federal legislation had a negative impact on SLM's ability to generate income from FFELPs loans, PELs income generating capacity as SLM's “economic engine on the loan side of the business” became even more significant. Thus, in the first statement by SLM about its financial condition since the Third Quarter 2007 earnings announcement, Lord's failure to provide a persuasive response to concerns raised about the credit quality of the PEL portfolio, coupled with the revelation that the private credit provision was being raised, fueled investor concerns over SLM's financial condition and caused the stock price to dive. SLM's prices slid from the opening price of \$28.85 per share on December 19, 2007 to close at \$22.89 per share, representing a one-day decline of 21%. While 12.37 million SLM shares traded on December 18, 2007, 58.5 million and 58.46 million SLM shares traded on December 19, 2007 and December 20, 2007, respectively. Sallie Mae's stock continued to trade down thereafter.

159. A December 20, 2007 article in the *Wall Street Journal* entitled “Sallie Offers Little on Strategy CEO, in Investor Call, Fails to Assuage Worry As Shares Slide by 21%,” observed that Lord’s refusal to answer questions “rattled investors.”

**B. The January 3, 2008 8-K Report**

160. On January 3, 2008, the Company filed a Form 8-K and press release with the SEC which stated, in part:

Our management team is evaluating certain aspects of our business as a response to the impact on our business of The College Cost Reduction and Access Act of 2007 (the “Act”), and current challenges in the capital markets....As a result, we expect that the Act will significantly reduce and, combined with higher financing costs, could possibly eliminate the profitability of new FFELP loan originations, while increasing our risk sharing from our FFELP loan portfolio.

In response to the Act and market conditions, we plan to be more selective in pursuing origination activity, in both FFELP loans and private education loans....We expect to continue to focus on generally higher-margin Private Education Loans, both through our school channel and our direct to consumer channel, although in the case of the latter, with particular attention to continuing the more stringent underwriting standards that are necessary in this market. We also expect to adjust our private education loan pricing to reflect the current financing and market conditions.

161. This press release provided additional adverse information to the marketplace concerning both the public and private loan portfolios and future business prospects in those businesses. In particular, it informed the marketplace that Defendants were relying, even more than had previously been disclosed, on the PEL portfolio as the “economic engine” of the Company. However, as the doubt and uncertainties fostered by Defendant Lord at the December 19, 2006 conference with regard to the extent of credit problems in the private loan portfolio had not been clarified, the negative market reaction which followed the January 3 press release reflected, at least in part, deepening concern and uncertainty about these problems. The market knew from the statements in the press release that even more stringent underwriting standards

had to be applied, especially to the direct-to-consumer channel of the PEL, referred to loans to non-traditional students and therefore added to the existing uncertainty about the performance and valuation of SLM's PEL portfolio.

162. SLM's stock dropped from its \$19.16 per share closing price on January 3, 2008 to close at \$16.67 per share on January 4, 2008.

163. On January 22, 2008, Corinthian Colleges, Inc., a for-profit post-secondary education company, filed an 8-K with the SEC which stated, that, on January 18, 2008, it had been informed by Sallie Mae that, effective March 1, 2008 SLM would no longer make private loans available for students who present higher credit risks (i.e. subprime borrowers).

164. Thereafter, other institutions in the for-profit sector, including Career Education Corp., made similar disclosures regarding Sallie Mae's change in policy.

**C. January 23, 2008 Press Release and Conference Call**

165. On January 23, 2008, the Company issued a press release entitled "Sallie Mae Announces Fourth-Quarter and Full-Year 2007 Results." The Company said that student loan originations totaled \$5.0 billion in the 2007 fourth quarter and \$25.5 billion during the full-year 2007, and that student loans originated through its internal brands, the most profitable segment of total student loan originations, grew 27 percent year over year to \$16.6 billion. For the full-year 2007, "core earnings" net income was \$560 million, compared to \$1.3 billion in 2006. The Company reported a fourth-quarter 2007 "core earnings" net loss of \$139 million, or \$.36 diluted loss per share, compared to net income of \$326 million, or \$.74 diluted earnings per share, in the year-ago period. Driving the 2007 fourth-quarter's loss were provisions for loan losses of \$750 million on a "core earnings" basis (or \$575 million on a GAAP basis) compared to \$88 million in

the year-ago quarter. The increase in the loan loss provision related primarily to the actual and expected performance of the non-traditional, higher-risk portion of the company's managed student loan portfolio.

166. Defendant Lord, John (Jack) F. Remondi (SLM Vice Chairman and CFO), Tony Terracciano (SLM Chairman of the Board), and Steve McGarry (SLM Senior Vice President, Investor Relations) hosted the Company's January 23, 2008 Q4 Earnings Conference Call ("Q4 Call"). During the conference call, they made the following admissions concerning SLM's loan loss provisions:

[Lord]: Jack and I have been trying to unravel and isolate the cause of the previous three quarters loan losses that were so far in excess of what they had been in previous years. *We have very closely identified these assets and their assets have basically--were created in a way that's a little different than what we believe is our lending philosophy, and certainly is now our lending philosophy.* And that is that education builds credit worthiness. I mean that is clearly our philosophy. We've seen it for 35 years in the guaranteed side of the business. We've seen it very much even in the private side. *But we have over the past several years, violated that policy.* Credit worthiness for young people tends to be very independent of Standard measures and concluding things like FICO although we look at FICO. *And if there's one single variable that's critical, its graduation.*

Graduation is critical. *Sallie Mae may have lent too much money to students who have gone to schools without very good graduation records.* Such students at such schools are virtually singly responsible for 60% of the '07 credit losses. *Our methodology in creating loan loss provisions tended to look backwards. Because that's the information that we had. But we have specifically identified the borrowers who are not likely to graduate and provided for them this quarter, its a -- frankly a different reserving methodology, but we know those assets are going to default.* And so we have reserved for them. Jack will get into far more detail and lay this out in a way that's comprehensible shortly. I believe our long-term charge off numbers will be less than 3% and in fact the relevant numbers for '07 for the assets that we would say are traditional school assets are something less than 2%.

*The company has stopped making loans that were predictably not collectible.* You may have seen the announcements. I think three of our major customers and unfortunately what was bad news for us in this quarter has turned out to be very bad news for them as well.

167. Remondi also made the following statements during the call:

Our core earnings for the year totaled \$560 million, a 57% decrease on earnings per share to \$1.23. This was – the decrease here was primarily driven by the large increase in our loan loss reserve, our provision per loan losses on our private portfolio. Our provision increased by 1.1 billion over 2006.

***The bulk of the reserve though, was driven by the private credit portfolio with a 961 million increase in the private loan provision.*** This increase was driven by worse than expected default trends in a very limited segment of our overall portfolio, its the portfolio that we will refer to as our nontraditional loans. These are loans that are made to lower tier credit borrowers and are attending, for the most part, schools that have a different profile than other institutions. And mostly due to types of degrees that they offer, more associate versus bachelors and as well as the type of students that attend those institutions. I want to be clear here that it's not a – it's not as easy to say, as I think some people have said, for profit, non-profit, those are not distinctions that adequately describe the areas of concern here. This is really a segment of the schools that for one reason or another are bringing in students but not producing graduates. Or if they are producing graduates their graduates are not earning sufficient – they haven't gained a sufficient economic benefit to generate the earnings to pay off and meet the debt obligations associated with their loan. And that's the business that we will be exiting.

And in 2007, we experienced a ***significant decline in the credit quality associated with that segment of the portfolio. These loans today equal about 15% of our managed private credit portfolio, but they generate 60% – or contributed 60% of our total charge offs in 2007. Obviously, a business model that does not make sense. From our long history, we know that graduation is the key to credit quality in the student loan space. You can see how much higher not only our delinquency rates associated with these loans which run more than six times higher the delinquency rates of our traditional loan portfolios, and these are delinquencies over 90 days. But that they also experience even higher defaults or charge off rates. These loans default at almost eight times the rate that we see in the traditional portfolio.***

And just to be clear, once again with these changes, we would expect the provision in 2008 to decline. We implemented programs that delayed the disbursement of loans between 60 and 90 days after enrollment in order to capture early withdrawal events at these institutions and we also implemented, in 2007, some significant risk sharing agreements with students attending certain schools in this category that had those institutions pick up a material portion of what we would expect to be the default exposure on those loans. That would lead one to believe that our 2007 vintage portfolio, as it enters are repayment, will see better default trends than earlier segments of the portfolio but we still believe they

represent an unacceptable level of default losses and will – was a factor in why we are exiting this business.

*As we saw earlier, 65% of our charge offs came from students who withdrew. It's very difficult to collect on that loan over time.* (Emphasis added.)

168. In response to another question posed by an audience member, Remondi explained, in relevant part:

The Department of Ed published a study earlier this year that took a look for the – it's the first time I've seen this from the Department, a cohort year — a cohort life of loan analysis on a portfolio of loans that was originated in 1985 and look at how these loans performed over the next 20 years. And what they found was that for kids who borrowed and graduated the default rate—the cumulative default rate on FFELP loans—and remember these collection processes in FFELP are compliance driven they are not collection driven was 2%. *For those students who borrowed and didn't graduate, the cumulative default rate was 22%. So, 11 times higher. This is a crucial component. If we can identify schools and identify borrowers who are likely to graduate, the private credit business is going to be an extremely profitable business for us....*(Emphasis added.)

169. The information provided in the study cited by Remondi was not new and was known to or recklessly disregarded by Defendants as they rapidly grew the non-traditional PEL business. SLM knew or recklessly disregarded that non-traditional schools had very low graduation rates and that students who failed to graduate had a high probability of defaulting on their loans. In June 2005 the National Consumer Law Center published a report entitled “Making the Numbers Count: Why Proprietary School Performance Data Doesn't Add Up and What Can Be Done About It.” The report provided examples of the poor graduation rates from nontraditional schools and noted the strikingly low completion rate for four year programs at the following schools: Apollo Group's rate was 7%; Corinthian's was 31%; Education Management Corporation's was 47%; ITT's was 49%; and Career Education Corporation's was 59%.

170. On January 23, 2008, Defendants pointed out that while a substantial loan loss provision had to be taken in SLM's non-traditional loan portfolio, the Company was exiting that business to focus on more stable traditional loans. The Company made clear that it would

concentrate on loan quality and the returns to be received on each product and raised its underwriting standards which analysts perceived as being a long-term positive for SLM.

171. Contrary to SLM's statements, numerous pre-Class Period studies show that there is a correlation between a student's failure to graduate from school and the probability that the student will default on their loans. See Robin McMillion, *Student Loan Default Literature Review*, TG RESEARCH AND ANALYTICAL SERVICES, Dec. 22, 2004. For example, a study from 1998 demonstrated that students who attend proprietary schools have high default rates and that the highest default rates are among those borrowers who left school without a degree. J. Fredericks Volkwein, et al, *Factors Associated with Student Loan Default Among Different Racial and Ethnic Groups*, 69 *Journal of Higher Education*: 206-37 (1998). Furthermore, a student's failure to complete an academic program is strongly associated with student loan default or attending a nontraditional school with programs that lasted less than 2 years. Jennie H Woo, *Factors Affecting the Probability of Default: Student Loans in California*, 32 *NASFAA JOURNAL OF STUDENT FINANCIAL AID*, (2002).

172. The dubious quality of PELs is reflected in SLM's post-Class Period change to the definition of PELs in the Company's SEC filings. This material information about non-traditional school students' poor creditworthiness never appeared in SLM disclosures or SEC filings before or during the Class Period. In the Company's Form 10-K Report for the year ended December 31, 2007, filed on March 2008, and in its first quarter, second quarter, and third quarter reports for 2008, SLM included the following paragraph in its definition of PELs:

In the context of our Private Education Loan business, we use the term 'non-traditional loans' to describe education loans made to certain borrowers that have or are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates or, where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance.

173. In or about 2004, the Company, made a conscious determination to grow its PEL business, and subsequently referred to it as the “economic engine” of its growth and profits. Thus, Defendants knew or recklessly disregarded the substantial risks to investors from the especially high risk segment of its business, but failed to make these disclosures, or any meaningful disclosure of the nature, size and risk of this non-traditional business, in its communications to shareholders and the market, including SLM’s 10-K for FYE 2006, or in its quarterly reports for 2007.

#### **VIII. EVENTS, DISCLOSURES, AND ADMISSIONS AFTER THE CLASS PERIOD**

174. In a June 5, 2008 Wall Street Journal titled, *SLM’s Headmaster on Lesson’s Learned*, Defendant Lord was asked,

Earlier this year, Sallie Mae indicated it would become more selective in making private-student loans, noting defaults were concentrated among nontraditional proprietary schools where students often fail to graduate. Why were you making such loans in the first place?” Lord’s answer: ***“It was obviously a mistake*** and I’m not going to step away from responsibility because I was either chairman or CEO when those loans were made. We got a little too confident in our own view that credit scores are of limited meaning for undergraduates. ***Maybe as early as 2004, we started lending with less selectivity.*** The culture of the company has been a FFELP culture for 35 years. That meant you made every loan to every student. I guess with 35 years of experience of saying yes, we were just not very good at saying no. (Emphasis added.)

175. On September 10, 2008, Defendant Lord spoke at the Lehman Brothers Global Financial Services Conference and admitted that the Company did not have adequate underwriting practices for non-traditional loans. Lord conceded:

We shouldn’t have non-traditional borrowers, but we do. In fact about 15% of our portfolios are what we call non-traditional borrowers. It’s basically kids and parents with poor credit risks who are at the wrong schools. The fact is we put 15% on—15% of this—of our book on over the ’04 to ’07 period basically because we got a little sloppy and ***began to I think engage in some wishful thinking in our underwriting practices.*** We’ve very much stopped doing that.

176. On October 23, 2008, CFO Remondi, Investor Relations Vice President McGarry and Defendant Lord hosted the Company's Q3 2008 Earnings Conference Call. During the conference call, Remondi acknowledged that SLM had failed to adequately screen borrowers who were granted forbearance. Remondi stated, in relevant part:

On the forbearance side, for example, we are applying far more analysis to requests that we receive to make sure that borrowers are both, one, committed to serving their debt, and two, have the actual ability to benefit from a forbearance, and so we are working in those areas. And this whole effort is really being led by a new team of individuals who are doing far more segmentation of the areas and analytical approach to that space.

177. During the earnings conference call, Remondi was asked: And then just on the credit side, is there any way to quantify the impact of having the tighter guidelines on forbearance, what impact that had maybe in terms of basis points on your delinquency rate this quarter?

178. Remondi responded:

There's no question that it increased delinquencies overall, and it contributed to the overall delinquencies across all delinquency buckets, but that's what is supposed to happen. Right? *What we are doing is we're taking -there's two categories of borrowers who don't get the forbearance, borrowers who don't need it so in effect avoiding or eliminating the convenience forbearance user and then borrowers who won't benefit from it.* If we don't think they're going to benefit from it, they're going to become delinquent borrowers, *and all that was happening-- all that would happen if we left them in a forbearance status is we'd be delaying a delinquent account. The goal here is to be far more analytical and understanding who can qualify--who benefits from a forbearance and ultimately is committed to repaying their account and by granting that will repay their loan. If we don't think they're not going to benefit, they don't belong in that status.*

179. During the Class Period, however, SLM provided forbearances without inquiring into the borrower's commitment or ability to repay their loans, despite Defendants' statements to the contrary, which had the effect that Remondi described—inevitable delinquencies were delayed.

180. The true facts, which were known or recklessly disregarded by Defendants, but concealed from the investing public during the Class Period, were as follows:

a. The Company failed to engage in proper due diligence in originating loans and granting forbearances to high-risk borrowers, particularly those attending non-traditional institutions;

b. The Company was not adequately reserving for uncollectible loans in its nontraditional portfolio in violation of GAAP, causing its financial results to be materially misstated;

c. The Company was manipulating its reported loans in delinquency by using improper grants of forbearance to non-paying borrowers in order to remove loans from the delinquency category, to shorten the delinquency period that would otherwise be attributed to non-paying loans and thus to reduce the allowance for loan loss that would otherwise be established had those loans been correctly classified as delinquent or charged off as uncollectible.

d. The Company failed to disclose known trends and uncertainties as required by SEC regulations concerning collection issues with respect to its non-traditional loan portfolio, and,

e. The Company had far greater exposure to anticipated losses and defaults related to its nontraditional loan portfolio than it disclosed;

181. A result of defendants' false statements, Sallie Mae's stock price traded at inflated levels during the Class Period. However, after the true risks of Sallie Mae's seeped into the market, the Company's shares were hammered by massive sales, sending them down more than 71% from their Class Period and near-all-time-high of \$57.98 per share in July 2007.

**IX. SALLIE MAE'S FALSE FINANCIAL REPORTING AND GAAP VIOLATIONS**

182. In order to inflate the price of Sallie Mae's stock, SLM failed to disclose the information set forth above and Defendants caused the Company to (1) falsely report its results for year-end 2006 and for the first three quarters of 2007 by failing to record adequate loan loss provisions, which materially overstated (understated) the Company's net interest income after provision for loan losses, income (loss) before taxes and minority interest in net earnings of subsidiaries, and net income (loss), and (2) conceal known trends and uncertainties with respect to its non-traditional loan portfolio. The results for year-end 2006 and for the first three quarters of 2007 were included in SLM's 2006 Form 10-K and each of the Forms 10-Q filed with the SEC during 2007. The results were also included in press releases disseminated to the public.

183. These representations were false and misleading as to the financial information reported, as such financial information was not prepared in conformity with GAAP, nor was the financial information a "fair representation" of Sallie Mae's financial condition and operations, causing the financial results to be presented in violation of GAAP and SEC rules.

184. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time.<sup>7</sup> SEC Regulation S-X states that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading or inaccurate, despite footnote of other disclosure. (17 C.F.R. §210.4-01(a) (1)). Regulation S-X additionally requires that interim financial statements must also comply with GAAP, with the exception that interim

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<sup>7</sup> The American Institute of Certified Public Accountants ("AICPA") Auditing Standards Board ("ASB"), in Auditing Standards ("AU") § 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*, AU § 411.02.

financial statements need not include disclosures that would be duplicative of disclosures accompanying the latest annual financial statements. (17 C.F.R. §210.10-01(a)).

185. In addition to being required to present financial statements in accordance with GAAP, the Securities Exchange Act of 1934 (“the Exchange Act”), as amended, requires every reporting company to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions of the Company. (15 U.S.C. §78m).

186. In violation of both GAAP and SEC rules, Sallie Mae’s Class Period 2006 Form 10-K and 2007 Forms 10-Q failed to: (a) provide an adequate loan loss provision for its PEL portfolio; (b) accurately disclose Sallie Mae’s forbearance practices; (c) adequately disclose concentrations of risk; and (d) disclose known trends and uncertainties related to Sallie Mae’s operations.

**A. Disclosure of Delinquency Results**

187. Sallie Mae’s forbearance practices, which removed loans from delinquency categories, allowed Sallie Mae to materially misstate its reported delinquencies and related delinquency statistics (e.g., delinquencies as a percentage of Private Education Loans in repayment).

188. Delinquency numbers and related delinquency statistics (charge-offs)<sup>8</sup> are important factors used to determine a portfolio's credit quality. Credit quality, in turn, directly impacts financial results and a lending facility's ability to raise cash, i.e. through securitizations. As disclosed by Sallie Mae, “Delinquencies have the potential to adversely impact earnings if the account charges off and results in increased servicing and collection costs.” (e.g., 2006 Form 10-K). Sallie Mae, for instance, disclosed in its Notes to the Consolidated Financial Statements and

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<sup>8</sup> Charge-offs are loans that are uncollectible and therefore are written off (removed from) Sallie Mae’s balance sheet.

the Management Discussion and Analysis (“MD&A”), the amount of loans in forbearance and the amount in each delinquency category (e.g., current, 31-60 days past due, 61-90 days past due, and greater than 90 days past due). As discussed above, Sallie Mae’s forbearance practices served to artificially improve the picture of the credit quality of the Company’s various loan portfolios.

189. The manipulative use of forbearance also permitted Sallie Mae to avoid larger loan loss provisions and lower market value for its shares during the Class Period, delaying the ultimate disclosure of the true extent of the deterioration of its PEL portfolio. Published figures show that this category of loans, which usually were non-performing but which were deemed current instantly upon exiting forbearance, was material and increased dramatically during the Class Period.

190. Calculating the forbearance loan value in the PEL portfolio as a percentage of total 30 day, 60 day and 90+ day delinquent loans on a managed basis illustrates how forbearance concealed the true delinquency problem at Sallie Mae. The following chart, which is in millions of dollars, demonstrates the increase in forbearance loans as a percentage of delinquent loans:

<u>Q Ending</u>	<u>Forbearance (F)</u>	<u>30/60/90+ Delinquent (D)</u>	<u>F/D</u>
12/31/06	\$1181	\$1010	117%
3/31/07	1641	971	169%
6/30/07	1637	965	170%
9/30/07	1952	1089	179%
12/31/07	2391	1227	195%

191. Contrary to what one would expect in a period of growing financial turmoil, delinquent loans in the PEL business segment grew by only \$73 million, or 8% from year-end

December 31, 2006 to quarter-end September 30, 2007, while loans in forbearance grew by \$871 million, or 73%. Loans in forbearance, which were already somewhat larger in amount than all delinquencies at year-end 2006, far exceeded the end of the third quarter 2007 delinquencies. As the chart shows, this trend continued in the fourth-quarter of 2007.

192. As stated by the Company, in its 2006 Form 10-K, Sallie Mae's evaluation of the adequacy of its allowance for losses, considered, the category of borrowers that were in "permitted non-paying status" (e.g., forbearance). However, as previously discussed, Sallie Mae permitted loans to go into forbearance (e.g., non-paying status) without proper due diligence (e.g., obtaining evidence as to the borrowers' ability to pay). Therefore, many loans that had been subjected to forbearance were improperly categorized as "permitted non-paying status." Accordingly, to the extent categorization of loans, included forbearance, as "permitted non-paying status," resulted in the Company applying a lower reserve factor to that loan, Sallie Mae's evaluation of the allowance for losses was fundamentally flawed, but undisclosed.

193. Further, as disclosed in Sallie Mae's 2006 Form 10-K and its first, second and third quarter 2007 Forms 10-Q, "[l]oans exiting forbearance into repayment status [were] considered current *regardless of their previous delinquency status*." This methodology assumes, therefore, that both the exposure and, accordingly, the rate at which a loan was reserved (default and recovery rate) would be the same for current, paying borrowers (that had never been delinquent) as for borrowers that had been delinquent (and in some cases seriously delinquent) in the past and had been granted forbearances. There is no disclosure by Sallie Mae stating otherwise or, specifically, that the allowance for losses relating to loans exiting forbearance (into repayment status) was determined differently or separately than for paying borrowers that had never been delinquent.

194. Therefore, despite Sallie Mae's forbearance practices, (which did not require evidence that borrowers had the ability or willingness to pay), no additional exposure was assigned to "current" loans that had been provided a forbearance. Even in instances where the borrower may have made one payment toward delinquent amounts in order to "qualify" for the forbearance, such a payment would not equate to support that the borrower had the ability to pay or further, that the entirety of the amounts outstanding were collectible. In fact, while recent payments may alter the classification of a particular account, it does not necessarily indicate that an account is ultimately collectible.

195. The manipulative use of forbearance was highlighted in the August 14, 2008 Lehman Brother's report authored by Jonathan Glionna and Marina Fayerberg titled "*SLM Corp: Analyzing Private Loan Risk.*" The report noted:

At June 30, \$2.5 billion of private loans were in forbearance. ***If not for the existence of forbearance, many of these loans would be delinquent.*** They are, however, excluded from reported delinquency ratios, making the ratios less comparable to those reported for other lending products, in our opinion. Adding loans in forbearance to delinquent loans would nearly triple the delinquency rate, to 19.6% from the 7.7%. ***Similarly, net charges-off ratios are also favorably affected by forbearance.*** SLM normally charges-off loans after they have been delinquent for 212 days. However, the time a loan spends in forbearance does not count. To illustrate the effect forbearance can have on net charge-off ratios consider as an example a loan that spends six months in forbearance and then becomes delinquent. This loan would not be charged off until 212 days after the end of the forbearance period, which would be over a year since the last payment. Furthermore, the losses can be in forbearance multiple times before ultimately getting charged-off, which pushes the loan even further into the future....

Lately, ***the use of forbearance has increased***, a trend we consider indicative of weaker asset quality. Loans in forbearance grew in the second half of 2007 and the beginning of 2008, climbing to 16.4% of loans in the first quarter of 2008. The trend reversed in 2Q08, with this ratio ending the quarter at 13.0%. Over in the last five years 11% of loans have been in forbearance on average.

Jonathan Glionna and Mariana Fayerberg, SLM Corp. Analyzing Private Loan Risk, Aug. 14, 2008.

196. Sallie Mae's forbearance practices not only enabled Sallie Mae to minimize reported delinquencies and to present rosier, but materially inaccurate, delinquency statistics, as discussed above, but such practices allowed the Company to delay charging-off delinquent loans, thereby artificially improving the presentation of the quality of its loan portfolios. Thus, during the Class Period, Sallie Mae was able to record lower loan loss provisions and thereby lower loan loss reserves and concurrently, artificially and materially overstating (understating) reported net interest income after provision for loan losses, income (loss) before taxes and minority interest in net earnings of subsidiaries, and net income (loss). More specifically, the loan loss provision and allowance for losses on receivables for the year ended 2006 and the first three quarters of 2007 was understated because the forbearance practice allowed the Company to record a lower reserve for (record a provision for) loans that had been granted a forbearance than if the loans remained in the proper delinquency category. Specifically, as discussed above, implementing forbearance practices removed loans from delinquency categories, placed them temporarily in a forbearance category and ultimately placed them in the current category (upon the expiration of the forbearance period). Thus, a loan that was 180 days delinquent would be removed from the most delinquent category (Sallie Mae's stated policy was to charge-off loans after they became 212 days delinquent) for the entire forbearance period. If the borrower failed to make the required payments after the forbearance period was over, that borrower's loan would not appear in the 180-211 delinquent category until that borrower failed to pay for yet another 180 days. Thus, Sallie Mae avoided charging off that loan for over a year or more.

197. Statement of Financial Accounting Standards ("FAS") No. 5, *Accounting for Contingencies* ("FAS 5"), defines a contingency as follows:

...an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a

"gain contingency") or loss (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. (FAS 5, ¶1). (Footnote omitted).

198. Guidance regarding the accrual of a loss contingency in a company's books and records is provided by FAS 5 in the following manner:

An estimated loss from a loss contingency...shall be accrued by a charge to income if *both* of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated. (FAS 5, ¶8). (Footnotes omitted.)

199. An example of a loss contingency includes the potential uncollectibility of receivables. (FAS 5, ¶4). Specifically with respect to the collectibility of receivables, FAS 5, ¶22 states:

The assets of an enterprise may include receivables that arose from credit sales, loans, or other transactions. The conditions under which receivables exist usually involve some degree of uncertainty about their collectibility, in which case a contingency exists as defined in paragraph 1. Losses from uncollectible receivables shall be accrued when both conditions [probable and estimable] in paragraph 8 are met. Those conditions may be considered in relation to individual receivables or in relation to groups of similar types of receivables. If the conditions are met, accrual shall be made even though the particular receivables that are uncollectible may not be identifiable.

200. Because Sallie Mae's policy was not to require borrower information supporting to collectibility, it was unable to properly and adequately set its Class Period loan loss reserves as it had insufficient information about collectibility. The allowance for loss on receivables for the year ended 2006 and the first three quarters of 2007 was also understated as a result of Sallie Mae's failure to record a provision that sufficiently covered the true quality of the PEL portfolio, including the non-traditional loan portfolio. Accordingly, net interest income after provision for loan losses, income (loss) before taxes, and minority interest in net earnings of subsidiaries and net income (loss) was materially overstated (understated) during this same period.

201. In determining an amount of probable loss in accordance with FAS 5 relating to a portfolio of loans, management is required to use its best estimate of the collectibility of associated receivables. Accordingly, lenders, such as Sallie Mae should include all information known about the various loans it has extended in reaching a conclusion regarding the collectibility of its receivables to satisfy that reasonableness threshold.

**B. Loan Loss Reserve Analysis**

202. Sallie Mae's 2006 Form 10-K disclosed the following with respect to evaluating the adequacy of the allowance for losses:

In evaluating the adequacy of the allowance for losses on the Private Education Loan portfolio, the Company considers several factors including: *the credit profile of the borrower and/or co-borrower, its status, i.e. whether it is in repayment versus being in a permitted non-paying status*, months of repayment, delinquency status, type of program and trends in defaults in the portfolio based on Company and industry data .... When calculating the Private Education Loan allowance for losses, the Company's methodology divides the portfolio into categories of similar risk characteristics based on loan program type, underwriting criteria and the existence or absence of a co-borrower, with a further breakdown for each of the factors mentioned above with these categories. The Company then applies default and recovery rate projections to each category. **The**

**Company's loss estimates are based on a loss emergence period of two years, including when borrowers are in school. Private Education Loan principal is charged off against the allowance when the loan exceeds 212 days delinquency.** Subsequent recoveries on loans charged off are recorded directly to the allowance. The Company's collection policies allow for periods of nonpayment for borrowers experiencing temporary difficulty meeting payment obligations which are referred to as forbearance. (Emphasis added.)

203. As such, the manner in which the Company estimated future losses was based upon historical experience (loss emergence period), including information relating to delinquencies, charge-offs, and recoveries. There is no indication, in the above disclosure, that the Company made adjustments to this methodology for future known and expected trends, both economic or specific to borrowers, thereby ignoring key information that should have been used by the Company in establishing its allowance for losses. This disclosure remained in effect until the fourth quarter of 2007.

204. In fact, prior to the 2007 Form 10-K, there is no recognition that external factors and/or forecasting data was used in the context of Sallie Mae's methodology when determining the allowance for losses on receivables. The Company's evaluation of the adequacy of the allowance for losses was modified in 2007, according to a disclosure in its 2007 Form 10-K. In that filing, Sallie Mae added the following language with respect to the migration analysis: "[a]dditionally, other factors are considered, including **external factors and forecasting data, which can result in adjustments to the formula based migration analysis.**" (Emphasis added.)

205. This is the first time that SLM noted its use of forecasting data to establish allowances for loan losses. This additional statement, in conjunction with Lord's January 23, 2008 statement that "Our methodology in creating loan loss provisions tended to look

backwards”, is an admission that Sallie Mae ignored external factors and forecasting data about which the Company was aware (e.g., actual and expected performance of the non-traditional, higher-risk portion of the company’s managed student loan portfolio) that should have been employed to estimate future losses, and in turn its loan loss provisions.

**C. Non-Traditional Loans**

206. As noted above, Sallie Mae offered PEL loans to borrowers attending non-traditional schools. Sallie Mae clearly was aware, at the time it was extending non-traditional loans, that the graduation rate for this category of borrowers was much lower than the graduation rate for borrowers to whom Sallie Mae had historically loaned funds. From the fourth quarter 2006 through the third quarter 2007, despite the Company’s knowledge that it was increasing its non-traditional loan portfolio which would ultimately result in a reduction of the number of its borrower students that would graduate and, therefore, increase the expected level of delinquencies. Sallie Mae failed to record a sufficient corresponding loss provision for expected losses on these loans.

207. Ultimately, in the 2007 fourth quarter, Sallie Mae was forced to take a charge to increase the allowance for losses by \$575 million (including \$503 million increase for the PEL portfolio) in order to cover actual and expected loan losses in its portfolio. In total, Sallie Mae’s loan provision for 2007 was \$1.4 billion compared to \$303 million for 2006.

208. Sallie Mae specifically disclosed the following pertaining to the additional charge recorded in the fourth quarter of 2007:

As a component of our Private Education Loan program, we made available to numerous schools various tailored loan programs that were designed to help finance the education of students who were academically qualified but did not meet our standard credit criteria. Management has recently taken specific steps to terminate these lending programs because the performance of these loans is materially different from originally expected, and

from the rest of the Company's Private Education Loan programs. In the fourth quarter of 2007, the Company recorded provision expense of \$667 million related to its Managed Private Education Loan portfolio. This significant increase in provision primarily related to the non-traditional lending programs described above which are particularly impacted by the weakening U.S. economy.

209. In the January 23, 2008 conference call, Defendant Lord explained, the increase in the fourth quarter 2007 provision as follows:

Our methodology in creating loan loss provisions tended to look backwards. Because that's the information that we had. But we have specifically identified the borrowers who are not likely to graduate and provided for them this quarter, it's a – frankly a different reserving methodology, but we know those assets are going to default.

210. This statement, when taken alongside the revision Sallie Mae made to its methodology for determining the allowance for loan loss, as disclosed in its 2007 Form 10-K,<sup>9</sup> is an admission that Sallie Mae ignored external factors and forecasting data of which the Company was aware (e.g., actual and expected performance of the non-traditional, higher-risk portion of the company's managed student loan portfolio) and from which it could have estimated future losses.

211. In violation of GAAP, specifically as a result of the Company's failure to adequately consider the true credit quality of its portfolio including the collectibility of loans that had been subject to forbearances and non-traditional loans, Sallie Mae failed to record an adequate loss provision for at least the quarter ended December 31, 2006 and the first three quarters of 2007 thereby understating its allowance for losses. Quarter after quarter during this

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<sup>9</sup> The Company's description of the migration analysis was modified in its 2007 Form 10-K Allowance for Loan Loss disclosure. In that filing, Sallie Mae added the following language with respect to the migration analysis: "[a]dditionally, other factors are considered, including **external factors and forecasting data, which can result in adjustments to the formula based migration analysis.**" (Emphasis added.) Prior to the 2007 Form 10-K, there is no recognition that external factors and/or forecasting data was used in determining the allowance for loss receivables.

timeframe, both the amount of loans in forbearance and the amount of loans extended to students entering non-traditional colleges increased substantially. Accordingly, based on: (a) the Company's own admission that the increase in provision in the fourth quarter 2007 was necessary because the loan loss methodology used in establishing the original allowance for loan loss looked backwards rather than considering the known, future, and expected loss relating to the PEL portfolio; (b) Sallie Mae's ability to specifically identify borrowers who were not likely to graduate and, therefore, its knowledge or reckless disregard of the actual and expected poor performance of PEL and particularly non-traditional loans; (c) Sallie Mae's deliberate failure to perform due diligence with respect to certain borrowers' ability to repay; and (d) the downward manipulation of the level of delinquent loans through the aggressive and improper use of forbearance, there is a compelling inference that the loan loss provision recorded in each quarter from at least the fourth quarter of 2006 through the third quarter of 2007 was materially lower than what was required by GAAP. By failing to record the necessary provision, each of net interest income after provision for loan losses, income (loss) before taxes and minority interest in net earnings of subsidiaries, and net income (loss) was materially overstated (understated) for at least the quarter ended December 31, 2006 and the first three quarters of 2007. The inadequate allowance for loan losses also deceived the market and along with the other misrepresentations and non-disclosures by Defendants concerning the quality of the Sallie Mae loan portfolios, concealed from the market the true risks inherent the PEL assets of the Company.

**D. Disclosure of Sallie Mae's Forbearance Practices**

212. A fundamental principle of financial reporting under GAAP is that useful information be provided to present and potential investors and creditors and other users. (FASCON No. 1, *Objectives of Financial Reporting by Business Enterprises* ("FASCON 1")),

¶34). Further, the information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence. (FASCON 1, ¶34).

213. FASCON 1 also provides that financial statements should include information about the Company's economic resources, its obligations and the events that would change any of those resources or any claims to those resources. (FASCON 1, ¶40).

214. Another fundamental principle states:

Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance. (FASCON 1, ¶42) (Footnote omitted).

215. Further, reliability is also a primary quality that makes accounting information useful for decision making. To be reliable, information must have *representational faithfulness* and it must be verifiable and neutral. (FASCON 2, ¶58-59, 62). As further defined by FASCON 2, in its *Glossary of Terms*, reliability is:

The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent.

216. In addition, FASCON 2, ¶79 states that the fundamental principle of “completeness” requires that nothing material is left out of the information that may be necessary to ensure that the financial statements validly represent underlying events and conditions.

217. FASCON 2 defines the concept of materiality in its *Glossary of Terms* as:

The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes

it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

218. Footnote disclosures in financial statements are an essential element of financial statements that are purportedly prepared in accordance with GAAP. FASCON 5 specifically states, in relevant part:

Information disclosed in notes...amplifies or explains information recognized in the financial statements. That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles. (§7) (Footnote omitted).

219. Additionally, APB No. 22, *Disclosure of Accounting Policies* ("APB 22"), states, in relevant part:

The Board concludes that information about the accounting policies adopted by a reporting entity is essential for financial statement users. When financial statements are issued purporting to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles, a description of all significant accounting policies of the reporting entity should be included as an integral part of the financial statements. (APB 22, §8, as amended by FAS 95 [1987]).

220. Further, APB 22 states, in relevant part:

Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations. In general, the disclosure should encompass important judgments as to appropriateness of principles relating to recognition of revenue and allocation of asset costs to current and future periods; in particular, it should encompass those accounting principles and methods that involve any of the following:

- a. A selection from existing acceptable alternatives;
- b. Principles and methods peculiar to the industry in which the reporting entity operates, even if such principles and methods are predominately followed in the industry;
- c. Unusual or innovative applications of generally accepted accounting principles... (APB 22, ¶12, as amended by FAS 95 [1987]). (Emphasis Added).

221. APB 22, ¶15 continues to state that disclosures are particularly useful when included in a separate *Summary of Significant Accounting Policies* section of public filings, preceding the remaining notes to the financial statements.

222. As noted above, Sallie Mae's public disclosures pertaining to its forbearance practices imply that the Company did obtain evidence of a borrowers' ability to pay prior to adjusting the delinquency status of the loan. This was not the case however. Sallie Mae did not obtain such evidence and, as such, Sallie Mae's Class Period representations failed to present an accurate description of the necessary requirements to obtain a forbearance. Sallie Mae's disclosures pertaining to the Company's forbearance practices were, therefore, materially false and misleading and violated the GAAP provisions outlined above.

223. More specifically, Sallie Mae did not satisfy GAAP when disclosing its accounting policies because it failed to provide: (a) useful information to present and potential investors and creditors; (b) comprehensible information to those with a reasonable understanding of business and economic activities; (c) reliable information (i.e., information that faithfully represented what it purported to represent); and (d) complete information (FASCON 1, FASCON 2).

**E. Disclosure of Concentrations of Risk**

224. FAS No. 107, *Disclosures about Fair Value of Financial Instruments* ("FAS 107"), as amended by FAS No. 133, *Accounting for Derivative Instruments and Hedging*

*Activities* (“FAS 133”), requires disclosures of all significant concentrations of credit risk arising from all financial instruments, including the following:

- a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- b. The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- c. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments
- d. The entity's policy of entering into master netting arrangements to mitigate the credit risk of financial instruments, information about the arrangements for which the entity is a party, and a brief description of the terms of those arrangements, including the extent to which they would reduce the entity's maximum amount of loss due to credit risk.<sup>10</sup>

225. Further, FASB Staff Position (“FSP”) SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk* (“FSP SOP 94-6-1”), issued in December 2005, tailored the guidance in FAS 107 to specific disclosure requirements for entities that originate, hold, guarantee, service or invest in loan products whose terms may give rise to a concentration of credit risk. The terms of certain loan products may increase a reporting entity's exposure to credit risk and thereby may result in a *concentration of credit risk* as that term is used in FAS 107, either as an individual product type or as a group of products with similar features. Such terms include principal payment deferral (e.g. forbearance terms).

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<sup>10</sup> FAS 107 ¶ 15A

226. Thus, Sallie Mae's failure to disclose: (1) the significant concentrations of credit risk arising from loans that were extended to borrowers attending non-traditional schools and (2) the maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration of non-performing loans failed completely to perform according to the terms of the contracts, constituted violations of GAAP. Thus, SLM's representations in its SEC documents filed during the Class Period, that its financial statements conformed to GAAP, were materially false and misleading.

**F. Trends and Uncertainties**

227. During the Class Period, in violation of SEC regulations, Sallie Mae also failed to disclose known trends and uncertainties concerning its non-traditional loan portfolio, which had been increasing during the Class Period. SEC Regulations, Item 7 of Form 10-K and Item 2 of Form 10-Q (Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")), require the issuer to furnish information required by Item 303 of Regulation S-K [17 C.F.R. §229.303] ("Item 303"). In discussing results of operations, Item 303 requires the registrant to:

Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed. (17 C.F.R. § 229.303(a)(3)(i)-(ii)).

228. Regulation S-K also states that "[t]he discussion and analysis [section] shall focus specifically on material events and uncertainties known to management that would cause

reported financial information not to be necessarily indicative of future operating results or of future financial condition." (17 C.F.R. § 229.303, *Instructions to Paragraph 303(a)*, (3)).

229. The SEC, in its May 18, 1989 Interpretive Release No. 34-26831 indicated that registrants should employ the following two-step analysis in determining when a known trend or uncertainty is required to be included in the MD&A disclosure pursuant to Item 303:

A disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have a material effect on the registrant's financial condition or results of operation.

230. The MD&A requirements are intended to provide, in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future. As Securities Act Release No. 33-6711 states:

The Commission has long recognized the need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company.

231. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

a. The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

b. The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

c. The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

d. The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

e. The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

f. The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

g. The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

#### **X. ADDITIONAL FACTS RELATING TO SCIENTER**

232. As alleged herein, Defendants acted with scienter in that they knew or recklessly disregarded that the public documents and statements issued or disseminated in Sallie Mae's name were materially false and misleading; knew or recklessly disregarded that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, the inference that Defendants knew or recklessly disregarded the true risks of the non-traditional PEL business and had the opportunity to act on that knowledge through the knowing manipulation of SLM's publicly reported student loan delinquency and loan loss reserves is strongly supported by virtue of their receipt of information reflecting the true facts regarding Sallie Mae, their control over, receipt, or modification of Sallie Mae's allegedly materially misleading misstatements, and their associations with the Company which made them privy to confidential proprietary information concerning Sallie Mae and their admissions with respect to SLM's underwriting and forbearance practices during the Class Period.

**A. The Merger**

233. Defendants had considerable motive to mislead and to falsify the nature of the information which they caused to be disseminated to the investing public due to the merger with the J.C. Flowers investor group through which SLM would receive a substantial premium over its stock price and Individual Defendants would receive huge cash payments (the "Merger"). In October 2006, Defendant Lord initiated negotiations with a private equity firm about the possibility of an acquisition of the Company. Thereafter, the negotiations continued throughout the end of 2006 and into the beginning of 2007 with the Company entering into a merger agreement in April 2007.

234. On April 16, 2007, the Company issued a press release entitled "Investor group to buy Sallie Mae for \$25 billion." The release stated in part:

'An investor group led by J.C. Flowers & Co. has signed a definitive agreement to purchase SLM Corporation..., commonly known as Sallie Mae, for approximately \$25 billion or \$60.00 per share of common stock, the companies announced today.'

The price offered by the Flowers group represented a significant premium over SLM's share price at the time, which, in the days prior to the announcement, was trading in the low \$40s.

235. On May 25, 2007, Sallie Mae filed its Preliminary Proxy Statement relating to the merger. Pursuant to the Proxy Statement, the Company disclosed that its officers and directors had certain interests in the merger that were different from the interests of the Company's shareholders, including the potential to receive large cash payments upon consummation of the merger and indemnity agreements which would protect the executives from past misconduct. The cash payments were to be based upon the conversion of the officers' and directors' equity interests in the Company at the effective time of the merger which included the automatic vesting of all outstanding stock options. At the time of the Merger, Defendant Lord was to

receive a cash payment of approximately \$225 million, and Defendant Andrews was to receive \$16.1 million.

236. Defendants' motive to present SLM in a positive light was compounded in 2007 when the Merger was jeopardized under the extraordinary circumstances of the February 5, 2007 proposal by President Bush to cut student lender rate subsidies, increasing lender risk, as well as the general tightening in the credit markets. On July 11, 2007, the Company issued a press release entitled "SLM Corporation provides update on transaction," which stated in part:

SLM Corporation...., commonly known as Sallie Mae, today announced that, in connection with the April 15, 2007 agreement providing for the acquisition of Sallie Mae, the acquiring entity, owned by affiliates of J.C. Flowers & Co., Bank of America and JPMorgan Chase, has informed Sallie Mae that it believes that *current legislative proposals pending before the U.S. House of Representatives and U.S. Senate "could result in a failure of the conditions to the closing of the merger to be satisfied."* Sallie Mae strongly disagrees with this assertion, intends to proceed towards the closing of the merger transaction as rapidly as possible and will take all steps to protect shareholders' interests.

237. In an October 2, 2007 letter, the Flowers group took the position that the impact of the federal subsidy cuts and the rising borrowing costs in the credit markets would slash Sallie Mae's core earnings by more than 14% in 2009 and by more than 20% in 2010 and that this constituted a "material adverse event" under the terms of the merger agreement.

#### **B. Equity Forward Contracts**

238. Defendants were further motivated by an extraordinary need to maintain SLM's share price due to a multi-billion dollar contingent liability under a risky financing technique involving the sale of equity forward contracts that would be triggered if SLM's share price dropped to certain lower levels. In recent years, Sallie Mae engaged in equity forward contracts related to the Company's securities as a way to raise money without borrowing. In an equity forward contract, an issuer, like SLM, sells its securities to a buyer and agrees to repurchase the

shares for a greater amount, the strike price, in the future if the market price falls to a certain lower level, the “trigger” price. The issuer is essentially placing a bet that the price of its shares will rise. If the market value of the underlying securities falls below certain predetermined “trigger” levels, the buyer of the contract has the right to terminate the contract and settle all or a portion of the original contract price, requiring the seller to pay the buyer the higher strike price.

239. As of December 31, 2006, the Company had outstanding equity forward contracts to purchase 48.2 million shares of its common stock at prices ranging from \$46.30 to \$54.74 per share with trigger prices ranging from \$20.84 to \$35.58 per share. In February 2007, the Company amended its equity forward contracts whereby the trigger prices were reduced with the highest trigger price being \$30.11 per share. As of February 28, 2007, the Company had outstanding equity forward contracts to purchase 48.2 million shares of its common stock at prices ranging from \$43.50 to \$54.74 per share with trigger prices ranging from \$23.93 per share to \$30.11 per share. This represents a contingent liability of over \$2 billion. It was thus important to Defendants that the Company maintain its share price above the predetermined trigger levels throughout the Class Period, as it sought initially to find a buyer for SLM and even more so as Defendants struggled to save the troubled Flowers Merger, and as SLM’s stock price began to fall during the Class Period.

240. As with the Merger, Defendant’s motivation to avoid triggering liability under the forward contracts was compounded by the subsidy cuts announced in February 5, 2007 that forced the Company’s share price perilously close to the trigger price. On December 13, 2007, the Company issued a press release entitled “SLM Corporation provides update on equity forward contracts,” which stated in part:

SLM Corporation...., commonly known as Sallie Mae, today announced that the company has amended or closed out certain equity forward contracts. As a result

of these transactions, the company's aggregate position on equity forward contracts is 44.0 million shares at an average strike price of \$44.30, with trigger prices ranging from \$24.75 to \$19.58.

241. Despite amending the trigger price again in early December, most of the trigger prices as set by the Company's equity forward contracts had been reached—meaning that the Company had lost its bet on its own share value and was required to settle its equity contracts

**C. Lord's Suspicious Stock Transactions**

**a. February 2007 Stock Sales**

242. The inference that Individual Defendant Lord knowingly participated in the fraudulent scheme alleged herein is particularly strong given the series of suspicious stock transactions Lord executed, arranged, or otherwise acquiesced to in 2007 in order to avoid millions of dollars in losses as SLM share value declined over the course of the Class Period, and which were based on non-public, proprietary information.

243. The first of three suspicious transactions occurred on February 1 and 2, 2007, in which he sold 400,000 shares of stock for an average price of \$45.80 per share reaping \$18.3 million in insider trading proceeds. This stock sale by Defendant Lord was especially fortuitous as it came days before the public release of President Bush's budget proposal on February 5, 2007. In the President's budget, he proposed cutting student lender rate subsidies and increasing lender risk at the same time that SLM was growing its PEL lending, including the highly speculative, non-traditional lending, the risk of which was being concealed from the marketplace. Lord knew that further erosion of federally guaranteed lending would focus more analyst attention on the quality of the PEL portfolios.

244. An internal Sallie Mae document entitled "Federal Government Relations Strategy" dated December 5, 2006, showed that the Company sought a meeting with President

Bush's budget office approximately two months before Lord sold his shares. House of Representatives Education Committee Chairman George Miller said the document "shows that Sallie Mae intended to have discussions with the administration about the president's budget before it was released to the public. That raises the question of what information Lord had, when he had it, and what he did with it." *See Congress Probes Sallie Mae, Bush Budget Meeting*, Reuters, Kevin Drawbaugh, May 24, 2007.

**b. Options Exercise and Stock Sales in August and December 2007**

245. On August 3, 2007, Sallie Mae announced, in a press release, that several members of the Company's Board of Directors must exercise their options to acquire SLM stock that was set to expire on August 13, 2007. Defendant Lord exercised 1,663,448 stock options on August 9, 2007, at an exercise prices ranging from \$18.33 to \$26.62 per option and opted to tender 1,139,510 shares to Sallie Mae at fair market value, which was \$49.33 per share at the time. Lord used the sale of the 1.1 million shares to pay the exercise price of the options and associated taxes. Lord retained the remaining 523,938 shares, the minimum allowable given the restriction on stock sales in effect at the time.

246. In an August 15, 2007, article entitled "Sallie Buyout May Move On," The New York Post reported:

Sallie Mae's shares rose as much as 3 percent yesterday on news that Albert Lord, the company's chairman, exercised stock options to buy 1.7 million shares of Sallie Mae.

He immediately sold 1.1 million shares to pay the exercise price of the options and related taxes, but held onto the rest, which gave some investors confidence that Lord thinks the deal will go through.

*But some analysts said Lord's decision to sell some of his stock now, when he could have likely borrowed the cash to fund the deal, shows that he believes the deal could be in jeopardy.*

*Banks were willing to finance the exercise price if Lord didn't want to sell the stock immediately, sources said.*

Zachery Kouwe, *Sallie Buyout May Move On*, N.Y. Post, Aug. 15, 2007.

247. As described above, on October 2, 2007, just weeks after Lord's August options exercise, the Flowers group announced that it interpreted the federal subsidy cuts and rising borrowing costs in the credit markets as a "material adverse event" and would not proceed with the merger.

248. On December 14, 2007, Lord sold 1,265,401 shares of stock, or 97% of his position in SLM, for an average price of \$27.36 per share reaping \$34.6 million in insider trading proceeds. The stock sale by Lord, which he purports was a margin call executed by his bank, was again fortuitous, as it came days before Sallie Mae would host a conference call in which it would disclose that the Company might be facing higher financing costs and that the Company would need to add capital. This news sent Sallie Mae's shares tumbling—closing down 21% in a day. The timing of these stock sales prompted another investigation by the SEC into the Company's disclosures in December 2007, both before and after its executives and directors traded their stock.

249. Lord reportedly claimed that his "bank sold [him] out" in December 2007 of 97% of his position in SLM pursuant to a borrowing arrangement and that it was "not a sign of [his] disillusionment with the company." See David S. Hilzenrath, *Sallie Shares Tumble After Lord's Tense Call With Investors*, WASHINGTON POST Dec. 20, 2007, at D01. He said that the sale represented, in fact, "[his] own belief in [his] company" and that he was simply "one more victim of an unfinished deal." *Ibid.* In truth, the timing of Lord's near total liquidation of his position in SLM during 2007 and the tens of millions of dollars in profit he reaped strongly support an inference that he had knowledge of the true risks of the non-traditional PEL business.

The inference is further supported by Lord's comments in *SLM's Headmaster on Lesson's Learned*, WALL STREET JOURNAL, Jan. 5, 2008, that SLM had been "a little too confident" and his remarks during the September 10, 2008 Lehman Brothers Global Financial Services Conference, that SLM had engaged in "some wishful thinking in [their] underwriting practices."

**XI. APPLICATION OF PRESUMPTION OF RELIANCE**  
**(Fraud-On-The-Market Doctrine)**

250. The market for Sallie Mae common stock was open, well-developed and efficient at all relevant times. As a result of Defendants' materially false and misleading statements and false financial reporting, Sallie Mae shares traded at artificially inflated prices during the Class Period. Plaintiff and other members of the Class purchased or otherwise acquired Sallie Mae stock relying upon the integrity of its market price and market information relating to Sallie Mae, and have been damaged thereby.

251. As described herein, during the Class Period, Defendants made or caused to be made a series of materially false or misleading statements about Sallie Mae's financial condition, business and operations. These material misleading misstatements created an unrealistically positive assessment of Sallie Mae's financial condition and its business, thus causing the price of the Company's common stock to be artificially inflated at all relevant times, and when disclosed, negatively affected the value of Sallie Mae common stock. Defendants' materially false and misleading statements during the Class Period resulted in Plaintiff and other members of the Class purchasing the Company's stock at such artificially inflated prices, and each of them has been damaged as a result.

252. At all relevant times, the market for Sallie Mae stock was an efficient market for the following reasons, among others:

(a) Sallie Mae common stock met the requirements for listing, and was listed and actively traded, on the NYSE a highly efficient market;

(b) As a regulated issuer, Sallie Mae filed periodic public reports with the SEC and the NYSE;

(c) Sallie Mae regularly communicated with public investors via established market communication mechanisms, including through regular dissemination of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as quarterly Earnings Conference Calls, communications with the financial press and other similar reporting services; and

(d) Sallie Mae was followed by securities analysts employed by major brokerage firms who wrote reports about the Company, and these reports were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

253. As a result of the foregoing, the market for Sallie Mae stock promptly digested current information regarding Sallie Mae from all publicly available sources and reflected such information in Sallie Mae's common stock price. Under these circumstances, all purchasers of Sallie Mae common stock during the Class Period suffered similar injury through their purchase of Sallie Mae common stock at artificially inflated prices, and a presumption of reliance applies.

## **XII. LOSS CAUSATION/ECONOMIC LOSS**

254. By misrepresenting its financial outlook, Defendants presented a misleading picture of Sallie Mae's business and prospects. Thus, instead of truthfully disclosing, during the Class Period, that Sallie Mae's business was not as healthy as represented, Defendants falsely reported Sallie Mae's financial outlook and its actual business prospects going forward.

255. These claims of profitability caused and maintained the artificial inflation in Sallie Mae's stock price throughout the Class Period and until the truth was revealed to the market.

256. Defendants' false and misleading statements had the intended effect and caused Sallie Mae's stock to trade at artificially inflated levels throughout the Class Period, reaching its Class Period high of \$57.98 per share on July 9, 2007.

257. The truth about Sallie Mae's business operations, finances, business metrics, and future business and financial prospects reflecting the material false and misleading statements alleged herein, began to enter the market with a series of partial disclosures and revelations beginning in December 2007 which were accompanied by denials and continuing misrepresentations by Defendants. As a result, the artificial inflation in Sallie Mae's stock price did not come out of the stock all at once; rather, the artificial price inflation came out over time, in bits, pieces, and spurts as the stock continued to trade at artificially inflated, albeit lower, prices through January 2008.

258. As a direct result of Defendants' public revelations regarding the truth about Sallie Mae's overstatement of its financial outlook and its actual business prospects going forward, Sallie Mae's stock price fell from as high as \$57.98 per share on July 9, 2007 to less than \$19 after the end of the Class Period. This drop removed the inflation from Sallie Mae's stock price, causing real economic loss to investors who had purchased the stock during the Class Period.

### **XIII. NO SAFE HARBOR**

259. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. The specific statements identified herein were not forward looking, but related to historical facts for closed quarterly periods. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-

looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of Sallie Mae who knew that those statements were false when made.

#### **XIV. COUNT I**

##### **For Violation of §10(b) of the 1934 Act and Rule 10b-5 Against All Defendants**

260. Plaintiff incorporates §§1-259 by reference.

261. During the Class Period, Defendants disseminated or approved the false statements specified above, which they knew or deliberately disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

262. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

a. employed devices, schemes and artifices to defraud;

b. made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices and a course of business that operated as a fraud or deceit upon Plaintiff and others similarly situated in connection with their purchases of Sallie Mae common stock during the Class Period.

263. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Sallie Mae common stock. Plaintiff and the Class would not have purchased Sallie Mae common stock at the prices they paid, or at all, if

they had been aware that the market prices had been artificially and falsely inflated by Defendants' misleading statements.

## **XV. COUNT II**

### **For Violation of §20(a) of the 1934 Act Against the Individual Defendants**

264. Plaintiff incorporates ¶¶1-259 by reference.

265. The Individual Defendants acted as controlling persons of Sallie Mae within the meaning of §20(a) of the 1934 Act. By reason of their positions with the Company, and their ownership of Sallie Mae stock, the Individual Defendants had the power and authority to cause Sallie Mae to engage in the wrongful conduct complained of herein. Sallie Mae controlled the Individual Defendants and all of its employees. By reason of such conduct, the Individual Defendants are liable pursuant to §20(a) of the 1934 Act.

### **PRAYER FOR RELIEF**

WHEREFORE, Plaintiff prays for judgment as follows:

- A. determining that this action is a proper class action, designating Westchester Capital Management, Inc. as class representative under Rule 23 of the Federal Rules of Civil Procedure, and designating its counsel as counsel for the Class;
- B. awarding compensatory damages in favor of Plaintiff and the other members of the proposed Class against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;
- C. awarding Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

D. awarding such equitable, injunctive, or other relief as the Court may deem just and proper.

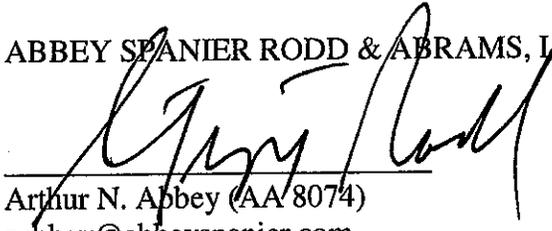
**JURY DEMAND**

Plaintiff demands a trial by jury.

DATED: December 8, 2008

Respectfully submitted,

ABBEY SPANIER RODD & ABRAMS, LLP



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Additional Plaintiff's Counsel

**CERTIFICATE OF SERVICE**

I, Carolyn Davila, hereby certify that on December 8, 2008, I caused the following documents:

CONSOLIDATED AMENDED CLASS ACTION COMPLAINT  
CERTIFICATE OF SERVICE

to be served upon the following counsel via Federal Express:

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