

Under Seal

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UNITED STATES DISTRICT COURT  
FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA  
EX REL. MICHAEL ZAHARA

Plaintiff,

v.

SLM CORPORATION,  
UNITED STUDENT AID FUNDS, INC., and  
STUDENT ASSISTANCE CORPORATION,

Defendants.

CV05-8020

C.A. No.

COMPLAINT FOR VIOLATION OF  
FEDERAL FALSE CLAIMS ACT  
(31 U.S.C. §§ 3729 *et seq.*)

JURY TRIAL DEMANDED

**FILED IN CAMERA  
AND UNDER SEAL**

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CENTRAL DISTRICT OF CALIFORNIA  
LOS ANGELES  
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**I. NATURE OF THE CASE**

1. Through his attorneys, qui tam plaintiff and relator Michael Zahara brings this action to recover damages and civil penalties on behalf of the United States of America arising from violations of the Federal Civil False Claims Act by defendants (1) SLM Corporation (better-known as "Sallie Mae" and hereafter referred to by that name), the nation's largest lender of federally guaranteed student loans; (2) United Student Aid Funds, Inc. ("USAF"), the nation's largest student-loan guarantor; and (3) Student Assistance Corporation ("SAC"), a wholly-owned subsidiary of Sallie Mae that performs services for USAF (collectively, "defendants").

2. This Complaint alleges a pattern and practice of fraudulent conduct by defendants in connection with the nation's largest federally guaranteed student loan program, the Federal Family Education Loan Program ("FFELP"). FFELP loans are provided by private lenders, and are insured against loss by the federal government, acting through non-profit guaranty agencies.

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1           3.       Foremost among the fraudulent practices alleged herein, defendants knowingly  
2 allowed their employees and agents to falsify loan records pertaining to delinquent FFELP loans  
3 held by Sallie Mae and guaranteed by USAF. In particular, defendants' employees and agents  
4 misrepresented in tens of thousands, and possibly hundreds of thousands, of call records that the  
5 delinquent borrower had been contacted by telephone and had verbally agreed to a loan  
6 "forbearance" (i.e., temporary relief from payment) when in fact the borrower had not been  
7 contacted and had not agreed to a forbearance of the loan. The purpose of fabricating  
8 forbearances in this manner was to extend the length of the delinquent loans and prevent the loans  
9 from going into default.  
10

11           4.       Fabricating forbearances benefited defendants, and defrauded the federal treasury,  
12 in a number of regards. First, the forbearances increased the amount of the borrowers' debt to  
13 Sallie Mae, the lender, because interest on a FFELP loan accrues and is capitalized during a period  
14 of forbearance. This amount is ultimately paid by the federal government upon default of the  
15 borrower. Secondly, fabricating forbearances artificially lowered the aggregate default rate,  
16 calculated annually, for the loans held by Sallie Mae and for the loans guaranteed by USAF. A  
17 decrease in the respective default rates of Sallie Mae and USAF increased various federal  
18 payments to the defendants, including (1) default aversion fees paid to USAF and passed on to  
19 SAC, (2) guarantee payments to Sallie Mae, and (3) reinsurance payments to USAF.  
20  
21

22           5.       As a result of the false and fraudulent statements and practices alleged herein,  
23 defendants caused the federal government to pay them hundreds of millions of dollars to which  
24 they were not entitled, all in violation of the Federal Civil False Claims Act, 31 U.S.C. §§ 3729 *et*  
25 *seq.* ("the FCA").  
26

27           6.       The FCA prohibits knowingly presenting (or causing to be presented) to the federal  
28 government a false or fraudulent claim for payment or approval. 31 U.S.C. § 3729(a)(1). It also

1 prohibits knowingly making or using a false or fraudulent record or statement to get a false or  
2 fraudulent claim paid or approved by the federal government. 31 U.S.C. §§ 3729(a)(2). In  
3 addition, the FCA prohibits conspiring with another person to defraud the government by getting a  
4 false or fraudulent claim allowed or paid. 31 U.S.C. §§ 3729(a)(3). Any person who violates the  
5 FCA is liable for a civil penalty of up to \$11,000 for each violation, plus three times the amount of  
6 the damages sustained by the United States. 31 U.S.C. 3729(a)(7).

7  
8 7. The FCA allows any person having information about false or fraudulent claims to  
9 bring an action for himself and the United States, and to share in any recovery. The FCA requires  
10 that the complaint be filed under seal for a minimum of 60 days (without service on the defendants  
11 during that time) to enable the government (a) to conduct its own investigation without the  
12 defendants' knowledge, and (b) to determine whether to join the action.

13  
14 8. Based on these provisions, qui tam plaintiff and relator Michael Zahara seeks  
15 through this action to recover damages and civil penalties arising from defendants' violations of  
16 the FCA.

## 17 **II. INTRODUCTION**

### 18 **A. The Larger Context Of This Case**

19 9. FFELP was created by Congress in Part B of the Higher Education Act ("HEA").  
20 Under the HEA, private lenders, such as Sallie Mae, use their own funds to make FFELP loans to  
21 students attending post-secondary schools.<sup>1</sup> The loans are guaranteed by the federal government,  
22 acting through non-profit guaranty agencies, such as USAF. The guaranty agencies administer the  
23 loan guarantee on behalf of the Department of Education ("ED").  
24

25  
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27  
28 <sup>1</sup> As used in this Complaint, the term "lender" refers both to the originating lender and any subsequent holder of the loan that acquired the loan from the originating lender. The term "lender" also refers to "loan servicers," who contract with the lender to handle activities required of the lender.

1           10.     If a borrower defaults on a FFELP loan, the guaranty agency pays the lender the  
2 amount owed on the loan, using federal monies held in a reserve fund called the "Federal Fund."  
3 The federal government in turn "reinsures" the guaranty agency, which means that the government  
4 pays back into the Federal Fund most of the amount of the guarantee payment.  
5

6           11.     Because FFELP lenders do not bear the risk for losses that occur through borrower  
7 default, Congress established a system to monitor the lenders in order to ensure that they diligently  
8 handle the origination and repayment of these loans. To protect the taxpayers, the HEA (1)  
9 imposes detailed requirements on all aspects of a lender's activities with regard to FFELP loans,  
10 and (2) creates a system of independent guarantor oversight of the lenders to ensure the lenders'  
11 compliance with these requirements. The independence of the guarantor protects the interests of  
12 the taxpayers in the payment of the FFELP loan guarantee.  
13

14           12.     Under the HEA, the guarantor must either be a state agency or a non-profit tax-  
15 exempt organization (such as USAF) that has been approved for that role by ED. The guarantor  
16 acts as the government's loan police. If the guarantor determines that the lender did not comply  
17 with all of its obligations under the HEA, the lender forfeits its right to receive a guarantee  
18 payment upon default of the borrower.  
19

20           13.     In this case, the system contemplated by Congress broke down, because USAF, the  
21 guarantor, did *not* exercise independent oversight of lender Sallie Mae. Instead, *USAF hired*  
22 *Sallie Mae to police itself*. Specifically, with regard to the forbearance practices that are the  
23 subject of this Complaint, USAF hired defendant Student Assistance Corporation ("SAC"), a  
24 division of Sallie Mae, to perform USAF's oversight of Sallie Mae's forbearance practices. Yet  
25 SAC was the same division that was *granting* the forbearances. Thus, SAC was put in charge of  
26 policing its own forbearance practices. This set the stage for the fraudulent practices alleged in  
27 this Complaint.  
28

1           14.     The precise nature of the work that USAF hired SAC to perform is called “default  
2 aversion” assistance. Under the HEA, a lender is required to request “default aversion” assistance  
3 from its guaranty agency for each loan guaranteed by that agency that is between 60 days and 120  
4 days delinquent (*i.e.*, overdue). The guaranty agency is obligated to provide this assistance in  
5 order to attempt to prevent the delinquent loan from going into default (also called bringing the  
6 loan “current” or “curing” the delinquency).

8           15.     USAF’s hiring of SAC to perform USAF’s default aversion work created a clear  
9 conflict of interest, since it placed SAC in the position of acting simultaneously on behalf of the  
10 guarantor (USAF, its client) and the lender (Sallie Mae, its parent). This conflict of interest  
11 directly violated HEA conflict of interest regulations. Those regulations provide:

12                   (k)(4) *Prohibition against conflicts.* If a guaranty agency contracts with an outside  
13 entity to perform any default aversion activities, that outside entity may not—

14                   (i) Hold or service the loan . . . .

15           34 CFR § 682.404(k)(4). Since Sallie Mae is the holder and servicer of the majority of loans  
16 guaranteed by USAF, USAF violated the above prohibition by hiring Sallie Mae’s SAC to  
17 perform USAF’s default aversion work.  
18

19           16.     In 2002, ED’s Office of Inspector General (“OIG”) examined the relationship  
20 between USAF and Sallie Mae and concluded in an Audit Report that USAF’s hiring of SAC to  
21 perform USAF’s default aversion work was indeed a conflict of interest and directly violated  
22 the above-quoted regulation. The report recommended that ED order USAF to cure the  
23 conflict.  
24

25           17.     Following issuance of the Audit Report, however, nothing was done to  
26 implement OIG’s recommendation. As a result, USAF continues to this day its practice of  
27 hiring Sallie Mae’s SAC to provide USAF’s default aversion services. This case shows the  
28 *consequences* of not acting upon the OIG’s recommendation.

1           18. Relator Michael Zahara worked at SAC between 2004 and 2005, and he  
2 witnessed first-hand a number of fraudulent practices that went undetected because SAC was  
3 acting simultaneously on behalf of the lender and the guarantor. This Complaint focuses in  
4 particular on one such practice that has a significant impact on the federal treasury: the  
5 fabrication of loan forbearances by SAC employees. SAC employees fabricated forbearances  
6 in such large numbers that, during the time period covered by this Complaint, SAC can aptly be  
7 described as a fraudulent “forbearance mill.”  
8

9           **B. The SAC Forbearance Mill**

10           19. “Forbearance” is the practice by which lenders grant delinquent borrowers  
11 temporary relief from their obligation to repay a loan. Forbearance is one among several debt  
12 relief options that can prevent a delinquent loan from going into default. Except in very rare  
13 circumstances, the HEA only permits lenders, not guarantors, to grant a forbearance.  
14

15           20. During periods of forbearance, the law permits the lender to capitalize interest,  
16 which means that the interest that accrues during the period of forbearance is added to the  
17 principal of the loan. Since FFELP loans are essentially risk-free to Sallie Mae, any activity that  
18 increases the borrower’s indebtedness, like a forbearance, ultimately increases Sallie Mae’s  
19 revenue from the loan.  
20

21           21. For a forbearance to be binding on the borrower, the borrower must agree to its  
22 terms. Prior to November 2002, federal regulations required that a forbearance agreement be in  
23 writing, signed by the lender and the borrower. In November 2002, ED issued new regulations  
24 that permitted the lender and borrower to agree verbally on the terms of a forbearance (referred to  
25 herein as a “verbal forbearance”).  
26

27           22. One risk associated with the new policy is that verbal forbearances can easily be  
28 fabricated. Employees of the lender responsible for contacting delinquent borrowers (referred to

1 herein as "call associates") can fabricate a verbal forbearance simply by entering a false notation  
2 in the loan records stating that on a given date the borrower was contacted by telephone and  
3 agreed to the terms of the forbearance.

4           23. The HEA provides a safeguard against such conduct by providing for independent  
5 guarantor oversight of the lender's forbearance practices, and forfeiture of the guarantee payment  
6 if the guarantor finds the lender in breach of its obligations under the law. But in this case the  
7 guarantor's independence was compromised because of the conflict of interest described above.  
8 USAF put SAC, the party that was granting forbearances on behalf of Sallie Mae, in charge of  
9 monitoring forbearances on behalf of USAF.

10           24. Given free reign over forbearances, SAC created a workplace environment that  
11 allowed, and even encouraged, its call associates to fabricate verbal forbearances on loans held by  
12 Sallie Mae and guaranteed by USAF. SAC created this environment through a combination of (i)  
13 intense pressure on call associates to prevent delinquent loans from going into default, and (ii) a  
14 deliberate absence of meaningful supervision of the calling activities of these associates.

15           25. SAC imposed a rigid performance quota system that required each call associate to  
16 prevent a specified dollar value of delinquent loans from going into default each month. The  
17 monthly quota was typically set at a such a high level that it pressured call associates to fabricate  
18 forbearances to achieve the quota. The quota system was enforced through discipline and  
19 termination for failure to meet the quota. SAC also used as a bonus system that brought group  
20 pressure to bear on individual call associates by making the bonus of every member of a team  
21 dependent upon each member of the team achieving the quota. The bonus system also encouraged  
22 a code of silence by giving everyone up the corporate ladder a share in the bonus of those below.  
23 In this environment, there was strong incentive to look the other way if call associates were  
24 meeting their quotas through fraudulent conduct.  
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1           26.     The pressure of the quota system was combined with a deliberate look-the-other-  
2 way attitude of defendants toward the calling activities of the SAC associates. During the period  
3 covered by this Complaint, neither SAC, Sallie Mae, nor USAF required verification of a single  
4 verbal forbearance granted by SAC call associates. Furthermore, SAC's system of random  
5 monitoring of the calling activities of the associates was a sham, with call associates being tipped  
6 off in various ways on the rare occasion that their calls were monitored.  
7

8           27.     Many SAC associates responded to this environment by routinely fabricating  
9 forbearances on loans of delinquent borrowers, particularly borrowers that were difficult to  
10 contact. By far the most common circumstance involved chronically delinquent accounts. These  
11 loans are typically very old, the borrower contact information outdated, and there is no realistic  
12 prospect of repayment. If these were Private Credit loans, where the lender bears the risk of loss,  
13 Sallie Mae would have forced the loan into default long ago and cut its losses; but because FFELP  
14 loans are essentially risk-free to Sallie Mae, it keeps extending the loans knowing that the  
15 government is ultimately responsible for paying the loan balance when the borrower defaults.  
16

17           28.     The simplest way for SAC call associates to fabricate a verbal forbearance was to  
18 remain on an unanswered call for at least two minutes, so that call records, if later audited, would  
19 indicate that the associate had been on the line long enough to have had an actual conversation  
20 with the borrower. Following the bogus call, the call associate would then enter into the loan  
21 records the false statement that the borrower had been contacted and had agreed to a forbearance.  
22 Another way to fabricate a verbal forbearance was to speak with anyone who answered the phone,  
23 such as a spouse, family member, or roommate -- none of whom have authority under the law to  
24 accept the terms of the forbearance -- and enter into the loan records that the borrower was  
25 contacted and agreed to the forbearance.  
26  
27  
28

1           29.     Based on the conduct that he observed while working at SAC, Relator estimates  
2 that during the period covered by this Complaint, SAC employees fabricated verbal forbearances  
3 on billions of dollars worth of FFELP loans held by Sallie Mae and guaranteed by USAF. The  
4 forbearance mill finally ended in June 2005, after Relator complained so loudly and persistently  
5 that SAC management realized that it could no longer turn a blind eye toward the practice. At that  
6 point, SAC finally put in place a system requiring supervisor verification of verbal forbearances.  
7 With that simple and obvious measure – *three years in coming* – the forbearance mill was  
8 effectively shut down.  
9

10           30.     Management at SAC, Sallie Mae and USAF allowed the SAC forbearance mill to  
11 persist as long as it did because all three companies benefited from the practice, and company  
12 executives gained personally through generous bonus compensation tied to company performance.  
13 The practice benefited the companies, to the detriment of the federal treasury, in a number of  
14 regards, including the following:  
15

16           a.       Since FFELP loans are virtually risk-free to Sallie Mae, increasing the principal  
17 and interest of the loans through forbearance ultimately increased Sallie Mae's revenue from the  
18 loans – received from the borrower in repayment of the loan, or from the Federal Fund upon  
19 default of the borrower.  
20

21           b.       The fabricated verbal forbearances increased the default aversion fees paid to  
22 USAF by ED. These fees are paid to the guarantor for preventing a delinquent loan from going  
23 into default. By preventing loans that otherwise would have defaulted from immediately going  
24 into default, the fabricated verbal forbearances allowed USAF to receive default aversion fees to  
25 which it was not entitled.  
26

27           c.       Fabricating verbal forbearances allowed SAC to meet performance goals  
28 established by USAF. Under the contract between USAF and SAC, meeting these goals entitled

1 SAC to receive a greater share of the default aversion fees paid by the federal government to  
2 USAF.

3 d. Fabricating verbal forbearances lowered the cumulative default rate on loans held  
4 by Sallie Mae. Keeping the default rate low helped Sallie Mae qualify for “Exceptional  
5 Performer” designation under the HEA, which allowed it to receive guarantee payments for 100%,  
6 rather than 98%, of the unpaid principal and interest on its defaulted loans.  
7

8 e. Fabricating verbal forbearances lowered the “cohort trigger default rate” on loans  
9 guaranteed by USAF. The federal reinsurance payment to guarantors goes down as the trigger  
10 default rate rises. By keeping the default rate on its loans low, USAF was able to qualify for the  
11 maximum reinsurance rate allowed by its reinsurance agreement with ED, rather than significantly  
12 lower rates that are triggered when the default rate rises.  
13

14 f. Sallie Mae’s cumulative default rate and USAF’s trigger default rate are measures  
15 of their respective success in preventing defaults on loans that they handle. Keeping their  
16 respective default rates artificially low enhanced each company’s reputation in the student loan  
17 industry and contributed to each company’s ability to continually grow their FFELP business, to  
18 the ultimate detriment of the taxpayers.  
19

20 **III. PARTIES**

21 **A. Plaintiff/Relator**

22 31. Plaintiff/relator Michael Zahara (“Relator”) is a resident of Las Vegas, Nevada. On  
23 November 29, 2004, he was hired by Sallie Mae to work as a “Default Prevention Specialist” at  
24 the Student Assistance Corporation (“SAC”). SAC is a division within Sallie Mae’s Debt  
25 Management Operations department. Relator worked at SAC’s Las Vegas, Nevada call center,  
26 also known as the Western Collections Center (“WCC”). Based on knowledge he gained while  
27 working for SAC, Relator became aware of the practices by defendants that are the subject of this  
28

1 Complaint. Relator's employment was terminated on August 16, 2005, in retaliation for  
2 complaining to company management and governmental authorities about the practices alleged  
3 herein. Relator brings this action for violations of the False Claims Act on behalf of himself and  
4 the United States pursuant to 31 U.S.C. § 3730(b)(1).

5  
6 **B. The Defendants**

7 32. Defendant SLM Corporation, more commonly known as Sallie Mae, is a Delaware  
8 corporation operating through a number of subsidiaries.<sup>2</sup> References in this Complaint to "Sallie  
9 Mae" refer to SLM Corporation and its subsidiaries. Sallie Mae's corporate headquarters are  
10 located in Reston, Virginia. Sallie Mae is the largest private source of funding for education loans  
11 in the United States. It manages over \$110 billion in student loans for over 9 million borrowers,  
12 including tens of thousands of borrowers in this judicial district.

13  
14 33. Sallie Mae was formed in 1972 as the Student Loan Marketing Association, a  
15 federally chartered government-sponsored enterprise ("GSE"), with the goal of furthering access  
16 to higher education by acting as a secondary market for student loans. In 1997, Sallie Mae  
17 obtained congressional and shareholder approval to transform from the GSE to a private sector  
18 corporation. Sallie Mae is now a fully privatized company. Its shares are listed on the New York  
19 Stock Exchange.

20  
21 34. Defendant United Student Aid Funds, Inc. ("USAF") is a non-profit, tax-exempt  
22 corporation with headquarters in Fishers, Indiana. USAF is the nation's largest guarantor of  
23 FFELP student loans. USAF guarantees FFELP loans for students and parents throughout the  
24 nation including in this judicial district. According to its 2004 Annual Report, USAF had  
25 approximately \$65 billion in student loan guarantees outstanding at the end of 2004.

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<sup>2</sup> Sallie Mae's United States subsidiaries include: Sallie Mae, Inc.; the Sallie Mae Servicing Corporation; SLM  
Financial Corporation; Student Assistance Corporation; Nellie Mae; Student Loan Funding Resources; Education One  
Group; General Revenue Corporation; Pioneer Credit Recovery, Inc.; and others.

1           35. Defendant Student Assistance Corporation (“SAC”) is a corporation headquartered  
2 in Fishers, Indiana. SAC is a wholly-owned subsidiary of defendant Sallie Mae. SAC is a  
3 division of Sallie Mae's Debt Management Operations department. SAC provides default aversion  
4 services on a contingency fee basis for student loan guarantors. SAC’s largest client is defendant  
5 USAF. SAC handles delinquent student loans of borrowers residing throughout the nation,  
6 including in this judicial district.  
7

8           36. The acts and omissions of SAC and its employees described in this Complaint are  
9 attributable not only to SAC, but also to Sallie Mae and to USAF, because SAC’s employees were  
10 acting as agents, employees, and/or under the direction and control of Sallie Mae and USAF when  
11 the acts and omissions occurred, and such acts and omissions were within the scope of such  
12 agency, employment, and/or direction and control. Accordingly, any reference in this Complaint  
13 to an act or omission of SAC or its employees shall be deemed to be the act of SAC and the act or  
14 omission of Sallie Mae and USAF.  
15

16 **IV. JURISDICTION AND VENUE**

17           37. This Court has jurisdiction over the subject matter of this action pursuant to both 28  
18 U.S.C. § 1331 and 31 U.S.C. § 3732, the latter of which specifically confers jurisdiction on this  
19 Court for actions brought pursuant to 31 U.S.C. §§ 3729 and 3730. Under 31 U.S.C. § 3730(e),  
20 there has been no statutorily relevant public disclosure of the “allegations or transactions” in this  
21 Complaint.  
22

23           38. Personal jurisdiction and venue are proper in this judicial district pursuant to 28  
24 U.S.C. §§ 1391(b) and 1395(a) and 31 U.S.C. § 3732(a), as one or more defendants are found in,  
25 have or had an agent or agents, have or had contacts, and transact or transacted business in this  
26 district.  
27

28 **V. APPLICABLE LAW**

1           39.     The Higher Education Act and its regulations cover every aspect of the life cycle of  
2 a federally guaranteed student loan, including loan originations, repayment, default prevention,  
3 collections, guarantee payments, and reinsurance payments. Pertinent provisions of the law are  
4 described below.

5  
6           **A.     Overview of Federal Student Loan Programs**

7           40.     The federal government operates two major student loan programs to help students  
8 and their parents meet the costs of postsecondary education: the Federal Family Education Loan  
9 Program (“FFELP”), formerly known as the Guaranteed Student Loan Program, authorized by  
10 Part B of Title IV of the HEA; and the William D. Ford Direct Loan (“Direct Loan”) program,  
11 authorized by Part D of Title IV of the HEA. Under both programs, the ultimate credit risk lies  
12 with the federal government. The major distinction between the two programs is that FFELP  
13 loans are provided by private sector lenders, while Direct Loans are provided directly by ED. In  
14 addition to these federal programs, private sector lenders make traditional Private Education Loans  
15 where the lender assumes the credit risk of the borrower.  
16

17           41.     This Complaint concerns FFELP loans. There are four types of FFELP loans  
18 currently authorized under the HEA:

19                   (1) Subsidized Federal Stafford Loans to students who demonstrate requisite  
20 financial need;

21                   (2) Unsubsidized Federal Stafford Loans to students who either do not demonstrate  
22 financial need or who require additional loans to supplement their Subsidized Stafford  
23 Loans;

24                   (3) Federal PLUS Loans to parents of dependent students whose estimated costs of  
25 attending school exceed other available financial aid; and

26                   (4) Consolidation Loans, which consolidate into a single loan a borrower’s  
27 obligations under various federal student loan programs.

28 These four types of loans will collectively be referred to herein by the umbrella term “FFELP  
loans.”

1 42. FFELP loans are low-interest loans with interest caps that limit the cost to  
2 borrowers. For each type of loan, the federal government establishes by statute the interest rate to  
3 be charged to borrowers.

4 43. The federal government provides lenders a variety of incentives to invest private  
5 capital in FFELP student loans. For example, the government provides FFELP lenders with a loan  
6 subsidy known as a "special allowance payment." This loan subsidy ensures private lenders that  
7 they will receive, at a minimum, a specified level of return on student loans. In addition, FFELP  
8 lenders are protected against borrower default by a guarantee payment insured by the federal  
9 government. The administration of the loan guarantee is discussed in the next section below.

10  
11 **B. The Administration of FFELP Student Loans**

12 44. All FFELP lenders - including the nation's largest, Sallie Mae - use their own funds  
13 to make FFELP loans to qualified borrowers. The loans are guaranteed by the federal  
14 government, which acts through intermediaries called "guaranty agencies." The guaranty agencies  
15 are either State agencies or private non-profit entities (such as USAF) that have signed an  
16 agreement with ED to perform certain administrative roles in the student loan program.

17  
18 45. Guaranty agencies receive and hold specially-earmarked federal funds for the  
19 purpose of paying lender default claims and certain other program costs and expenses. ED has  
20 described the role of the guaranty agency in the student loan program in the following terms:  
21

22 In light of its role in the program and its responsibility for holding and protecting  
23 Federal funds, the guaranty agency's role is best characterized as that of a trustee  
24 holding money for the benefit of another. . . . Under these circumstances, a guaranty  
25 agency is responsible for acting as a fiduciary responsible for protecting the interests  
26 of the Department and the taxpayers in the reserve funds.

27 61 Fed. Reg. 49381, 49381 (Department of Education, Notice of Proposed Rule, September 19,  
28 1996).

1           46. Under the HEA, guaranty agencies are required to monitor the practices of FFELP  
2 lenders to ensure that the lenders are properly originating loans and properly enforcing the  
3 repayment of loans they hold. Repayment of a FFELP loan begins six months after the student  
4 ceases to be enrolled in school at least half time. The initial six-month period before payments  
5 commence is referred to as the “grace period.”  
6

7           47. With a few exceptions, each FFELP loan must be scheduled for repayment over a  
8 period of not more than 10 years after repayment begins. The HEA currently requires minimum  
9 annual payments of \$600, unless the borrower and the lender agree to lower payments. The HEA  
10 regulations require lenders to offer borrowers the choice of a standard, graduated, income-  
11 sensitive and extended repayment schedule.  
12

13           **C. Borrower Repayment Relief**

14           48. The HEA provides various forms of repayment relief to borrowers who are having  
15 difficulty in making payments on their student loans. These provisions authorize lenders to  
16 temporarily or permanently cease the monthly repayments required under the loan’s amortization  
17 schedule. These provisions include (1) deferment, (2) forbearance, and (3) loan consolidation.  
18

19                   **1. Deferment**

20           49. A deferment is the temporary cessation of a borrower’s obligation to repay a loan  
21 because he or she meets certain specific conditions set forth in the law – such as returning to  
22 school, economic hardship, or being unemployed and seeking employment. For certain types of  
23 FFELP loans, during the deferment period the lender can defer both principal and interest,  
24 meaning that the loan balance will not increase because interest is not accruing. For other FFELP  
25 loans, the lender can defer principal only, which means that interest continues to accrue and the  
26 balance goes up during the deferment period.  
27

28                   **2. Forbearance**

1           50.     Forbearance is the temporary cessation of the borrower's obligation to repay a loan  
2 when the borrower is behind in payments but does not qualify for a deferment. Forbearance is  
3 generally lender-discretionary, whereas deferment is automatic when the statutory conditions for  
4 deferment have been met. The borrower is always responsible for the interest that accrues during  
5 periods of forbearance; and if unpaid, the interest may be capitalized (i.e., added to the unpaid  
6 principal balance of the loan).  
7

### 8                   3.     **Consolidation**

9           51.     Consolidation loans are made in an amount sufficient to pay outstanding principal,  
10 unpaid interest, late charges and collection costs on all federally guaranteed student loans that the  
11 borrower selects for consolidation. The borrower can use a consolidation loan to pay off a single  
12 loan or multiple loans.  
13

#### 14                   D.     **Delinquency And Default Prevention**

15           52.     A loan becomes delinquent the first day after a payment becomes due and is  
16 unpaid. Under the HEA, a loan that is delinquent for 270 days is considered eligible for "default."  
17 34 CFR 682.200. Once a loan becomes delinquent, and before it goes into default, the HEA  
18 requires the lender to undertake a series of federally prescribed "due diligence" efforts to try to  
19 enforce repayment of the loan. 34 CFR § 682.411(c)-(n). The required procedures consist of  
20 telephone calls, demand letters, skip tracing procedures to locate the borrower if his or her  
21 whereabouts become unknown, and requesting default aversion assistance from the guarantor. Id.  
22

23           53.     The lender is required to request default aversion assistance from the guarantor  
24 between the 60<sup>th</sup> day and 120<sup>th</sup> day of delinquency. 34 CFR § 682.411(i). (Sallie Mae's practice  
25 is to request the assistance on the 60<sup>th</sup> day of delinquency.) Upon receiving a request from the  
26 lender, the guaranty agency is required to pursue default aversion efforts prescribed by federal  
27 regulation. 34 CFR § 682.404. This assistance is aimed at preventing default by the borrower.  
28

1           54.     A guaranty agency may contract with an outside entity to perform the required  
2 default aversion activities; however, HEA regulations prohibit the guaranty agency from hiring the  
3 entity that holds or services the loan to perform these activities:

4                   (k)(4) *Prohibition against conflicts.* If a guaranty agency contracts with an  
5 outside entity to perform any default aversion activities, that outside entity may  
6 not—

7                   Hold or service the loan . . . .

8 34 CFR § 682.404(k)(4).

9           55.     During the time period covered by this Complaint, USAF was in continuous  
10 violation of this provision because it contracted with SAC – a division of Sallie Mae, the loan  
11 holder – to perform USAF’s default aversion activities. This conflict of interest placed SAC in the  
12 position of acting on behalf of both the guarantor and the lender with regard to the same loans, and  
13 compromised the system of independent guarantor oversight contemplated by the HEA.  
14

15           56.     Noncompliance with the HEA conflict of interest rules is grounds for disqualifying  
16 a guarantor from receiving government reinsurance payments on default claims paid to the lender.

17 See 34 CFR § 682.406(a)(12)(v).

18           **E.     The Consequences Of Default**

19           57.     If a loan does go into default, i.e., is delinquent for at least 270 days, the lender  
20 may submit a default claim to the guaranty agency, requesting that the guaranty agency pay the  
21 lender for the unpaid principal and accrued interest. If the guaranty agency determines that the  
22 lender has complied with all of its obligations under the HEA, the guaranty agency must pay the  
23 claim. The guaranty agency disburses the funds for the guarantee payment from a reserve fund  
24 called the “Federal Fund” that the guaranty agency holds in trust for the government.  
25

26           58.     The federal government reinsures the guarantee payment. This means that ED,  
27 after finding that the guaranty agency has complied with all of its obligations under the HEA,  
28

1 reimburses the guaranty agency for most of the amount of the default claim that the guaranty  
2 agency paid to the lender. ED's reimbursement payment is deposited into the Federal Fund. In  
3 addition, ED pays the guaranty agency a "default aversion fee" for every loan over 60 days  
4 delinquent that the guaranty agency prevents from going into default.

5  
6 59. Once a guaranty agency pays a lender's default claim, the loan is assigned to the  
7 guaranty agency and it becomes responsible for making diligent efforts to collect on the loan.  
8 Since ED reimburses a guaranty agency on default claims paid to the lender, the guaranty agency  
9 must return to ED most of the amount it collects from the borrower. As an incentive to continue  
10 to seek recovery of outstanding amounts due on loan defaults, a guarantor is permitted to retain a  
11 small portion of the revenue it collects from defaulted borrowers.

12  
13 60. The HEA requires guaranty agencies to establish two funds: the Federal Fund  
14 referred to above, and an Operating Fund. The Federal Fund contains the reinsurance payments  
15 paid to the guaranty agency by ED and the insurance premiums paid to the guaranty agency by the  
16 lender, among other funds. The Federal Fund is federal property and its assets may only be used  
17 to pay default claims of the lender, and to pay the guarantor's default aversion fees. 20 USC §  
18 1072(g). The default aversion fees, and other fees paid to the guaranty agency, are deposited into  
19 the Operating Fund. The Operating Fund is the guarantor's property and is used to support  
20 operating expenses.

21  
22 61. The manner in which the guarantee payment, the reinsurance payment, and default  
23 aversion fees are calculated and paid is described below.

24 **1. The Guarantee payment**

25 62. For defaulted FFELP loans that were made after October 1, 1993, the guarantee  
26 payment to lenders is 98% of the unpaid principal and accrued interest on the loan. The guarantee  
27 payment, however, increases from 98 to 100% if the lender (or loan servicer) receives an  
28

1 “Exceptional Performer” designation by ED. ED uses the Exceptional Performer status to  
2 encourage efforts to prevent defaults.

3 63. To qualify as an Exceptional Performer and receive 100% reimbursement on  
4 default claims, FFELP lenders must achieve an overall “compliance performance” rating of 97%  
5 or higher for due diligence requirements established by ED and must meet other criteria set by ED.  
6 34 C.F.R. § 682.415. Relator is informed and believes that ED examines, among other criteria, the  
7 cumulative default rate of loans held by the lender. The cumulative default rate is the total amount  
8 of the lender’s loans that are in default divided by the total amount of its loans outstanding. While  
9 Relator was working for SAC, company managers told the employees that the cut-off point for the  
10 Exceptional Performer designation was a 2% cumulative default rate, i.e., that Sallie Mae had to  
11 lower its default rate to less than 2% to receive the Exceptional Performer designation.  
12

13  
14 64. In addition to entitling the lender to receive 100% reimbursement on default claims,  
15 the Exceptional Performer designation has an additional advantage to a lender. Under FFELP  
16 program regulations, a lender designated an Exceptional Performer is also relieved from regular  
17 review for compliance with all of its due diligence obligations under the HEA.

18  
19 65. The Exceptional Performer designation lasts for a one-year period or until revoked  
20 by ED. The initial one-year period and any extensions are subject to quarterly compliance audits  
21 that can result in revocation of the designation. ED may revoke the designation at any time if it  
22 “has reason to believe the lender or lender servicer may have engaged in fraud in securing its  
23 designation for exceptional performance.” 34 CFR § 682.415(b)(8)(ii)(B).

24 66. Sallie Mae received an “Exceptional Performer” designation in October 2004 (and  
25 may have received that designation on earlier occasions of which Relator is unaware). Sallie Mae  
26 has received 100% reimbursement on default claims on FFELP loans since it received the  
27  
28

1 Exceptional Performer designation, rather than the 98% reimbursement rate that would have  
2 applied had it not received the designation.

3 **2. Reinsurance Payments.**

4  
5 67. When a guaranty agency has paid a lender's default claim, and the guaranty agency  
6 has complied with all of its obligations under the HEA, the guaranty agency is entitled to a  
7 reinsurance payment from the federal government to reimburse the guaranty agency for its  
8 payment to the lender. The amount of the reinsurance payment is governed by the terms of a  
9 "reinsurance agreement" between the guaranty agency and ED. The standard reinsurance  
10 agreement reiterates the requirements of the HEA and its regulations.

11  
12 68. Under the HEA and its regulations, the government's reinsurance payment  
13 obligation varies depending upon the guarantor's default rate experience. ED measures the  
14 guarantor's default rate experience by calculating the guarantor's "cohort trigger default rate" for  
15 each "trigger" year (October 1 through September 30). The cohort trigger default rate is defined  
16 as the dollar amount of defaulted loans guaranteed by the guarantor during the trigger year divided  
17 by the total dollar amount of the guarantor's loans in repayment. This default rate is called the  
18 "trigger" default rate because higher default rates trigger lower federal reimbursement payments to  
19 the guarantor.

20  
21 69. For loans disbursed on or after October 1, 1998, reinsurance payments cover 95%  
22 of the cost of the default claim plus certain administrative costs. This reinsurance rate is available  
23 only if the guarantor maintains an annual trigger default rate of less than 5%. If more than 5% of  
24 the guarantor's loans are in default, the reimbursement rate drops to 85%; and if default claims  
25 exceed 9% of loans in repayment status, the reimbursement rate drops to 75%. The HEA provides  
26 for slightly higher reinsurance rates for older loans. The following chart provides the reinsurance  
27 rates established by the HEA:  
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Loan Disbursement Date	Reinsurance Rate		
	Maximum	5% Trigger	9% Trigger
On or after October 1, 1998	95%	85%	75%
October 1, 1993 – Sept. 30, 1998	98%	88%	78%
Before October 1, 1993	100%	90%	80%

Reinsurance rates based on default-rate experience provide guarantors with strong financial incentives to prevent loan defaults.

**3. Default Aversion Fees**

70. The HEA provides FFELP guarantors with an additional incentive to prevent loan defaults in the form of a “default aversion fee.” When a guarantor successfully prevents a borrower who has fallen 60 days or more behind in loan payments from defaulting, the guarantor is entitled to receive a default aversion fee. The fee, which is paid from the Federal Fund, is equal to 1% of unpaid principal and accrued interest on the loan brought into “current status.” This fee may be paid only once per borrower, even if the same borrower subsequently falls more than 60 days behind in payments again. The fee must be rebated back to the government if the borrower subsequently defaults.

71. During the time period covered by this Complaint, all of the default aversion fees paid by the government to USAF were shared with SAC. This sharing agreement is part of SAC’s contract with USAF to perform the guarantor’s default aversion services. The contract provides SAC a financial incentive to prevent defaults on the loans that it services for USAF. According to the contract, USAF pays SAC a higher share of the default aversion fees when USAF’s annual trigger default rate goes down. The following table provides the payment formula at selected default rates:

Trigger Default Rate	% of USAF’s Default Aversion Fee Paid to SAC
5.0%	70% (minimum)
3.0%	81%
2.0%	87%
0.5%	95% (maximum)

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**F. Compliance With The HEA and its Regulations Is a Prerequisite To the Right Of A Lender Or Guarantor To Receive Federal Payments Under The HEA**

72. A lender’s right to receive payment for a default claim (paid by the guaranty agency out of the Federal Fund) is conditioned upon the lender’s compliance with all applicable requirements of the HEA with respect to the loan. Likewise, the guaranty agency’s right to receive a reinsurance payment from the federal government for default claims paid to the lender is conditioned upon both the lender’s and the guarantor’s compliance with their respective obligations under the HEA. The basic rule is stated in 34 C.F.R. § 682.406(a):

(a) A guaranty agency may make a claim payment from the Federal Fund and receive a reinsurance payment on a loan only if –

(1) The lender exercised due diligence in making, disbursing, and servicing the loan as prescribed by the rules of the agency; . . .

(3) The lender provided an accurate collection history and an accurate payment history to the guaranty agency with the default claim filed on the loan showing that the lender exercised due diligence in collecting the loan; . . . [and]

(12) The agency and lender, if applicable, complied with all other Federal requirements with respect to the loan . . . .

73. Defendants’ fraudulent practices alleged herein violated the HEA and FFELP program regulations and disqualified defendants from receiving the guaranty payments, reinsurance payments, and/or default aversion fees that defendants received in connection with the affected loans. Claims by defendants for these payments constitute false and fraudulent claims for payment under the False Claims Act.

**VI. THE OPERATION OF DEFENDANTS’ BUSINESSES**

74. In order to understand how the fraudulent practices alleged herein took place, it is necessary to understand something of how the defendants operate their respective businesses.

**A. Sallie Mae’s Business Operations**

1           75.     Sallie Mae manages its business through several business segments, the two largest  
2 of which are (i) the Lending Business/Loan Servicing segment and (ii) the Debt Management  
3 Operations segment (hereafter, the “Lending Division” and “DMO,” respectively).

4                           **1.     Sallie Mae’s Lending Division**

5           76.     Sallie Mae’s Lending Division is the largest holder of student loans and largest  
6 servicer of student loans in the country. It manages over \$110 billion in student loans for over 9  
7 million borrowers. Approximately 90 percent of these loans are federally guaranteed; the  
8 remainder are private education loans that are not federally guaranteed. Sallie Mae acquires its  
9 federally guaranteed student loans in one of two ways: it either originates the loans, or it buys the  
10 loans from the originating lenders on the secondary market.

11           77.     Sallie Mae’s Lending Division is in charge of all of the activities that Sallie Mae as  
12 lender is required to perform under the HEA. This includes activities related to loan origination,  
13 loan repayment, default prevention, and other activities. For purposes of this Complaint, it is  
14 important to note that the default prevention activities performed on behalf of the Lending  
15 Division are separate and distinct from the default prevention services that DMO provides to  
16 guarantors for a fee (discussed below).

17           78.     The granting of forbearances to delinquent borrowers is one of the default  
18 prevention activities that the Lending Division is formally in charge of on behalf of Sallie Mae as  
19 lender. During the time period covered by this Complaint, however, the Lending Division  
20 permitted SAC to grant forbearances to borrowers of Sallie Mae FFELP loans. This was an  
21 extraordinary delegation of authority by the Lending Division, given that SAC is within Sallie  
22 Mae’s DMO, not the Lending Division, and performs default aversion services on behalf of  
23 guarantors, not lenders. Sallie Mae is the only lender that allows its borrowers to receive  
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1 forbearances granted by SAC; every other lender requires SAC to forward forbearance requests  
2 directly to the lender.

3 **2. Sallie Mae's Debt Management Operations**

4 79. Sallie Mae's DMO provides debt collection and default prevention services for  
5 guarantor clients on a contingent fee basis. DMO employs over 3,500 people.

6 80. USAF is by far Sallie Mae's largest client for DMO services. Sallie Mae in return  
7 is USAF's largest client for loan guarantees. DMO, SAC, and USAF all have their headquarters  
8 in the same building complex in Fishers, Indiana. The interconnected relationship between Sallie  
9 Mae and USAF is discussed in greater detail in ¶¶ 87-91 below.

10 81. Sallie Mae's DMO subsidiaries include SAC, Pioneer Credit Recovery ("PRC"),  
11 General Revenue Corporation ("GRC"), and Arrow Financial Services ("AFS"). SAC provides  
12 default aversion services for four guarantors, by far the largest of which is USAF. GRC and PCR  
13 provide loan collections services for guarantors and ED. AFS is a debt management company that  
14 services several industries outside of student loans.

15 82. SAC is the DMO division where Relator worked, and where most of the activities  
16 described in this Complaint took place. SAC maintains Call Centers in Fishers, Indiana and Las  
17 Vegas, Nevada. Relator worked at the latter facility, known as the Western Collections Center  
18 (WCC). This facility was built by SAC's former parent, USA Group, and has been used  
19 continuously by SAC for many years. Sallie Mae took over the WCC in 2000 when it acquired  
20 the USA Group.

21 83. The Las Vegas operation of SAC reports to SAC's corporate headquarters in  
22 Fishers, Indiana. SAC headquarters reports to the DMO corporate office, which is also located in  
23 Fisher's, Indiana. As noted above, DMO shares the Fishers, Indiana office complex with USAF.

1           84. Relator was employed at WCC from November 2004 to August 2005. Relator's  
2 job title was Default Prevention Specialist ("DPS"). The responsibilities of a DPS consist of  
3 speaking on the telephone with delinquent borrowers in order to try to bring their delinquent  
4 accounts current. The position of DPS is referred to herein as "call associate." Approximately  
5 225 people are employed as SAC call associates at WCC.

7           85. During the time period covered by this Complaint, Relator's immediate supervisor  
8 was Mike Chernich, whose position was Supervisor, also known as Team Leader. Chernich  
9 reported to Mike Bluel, the Floor Manager. Linda Robbins was also a Floor Manager. Bluel and  
10 Robbins reported to Jeff Schnell, who was in charge of SAC operations in Las Vegas. Schnell  
11 reported to Robert Meck, Chief Operating Officer of DMO and based in Fishers, Indiana. Meck  
12 reported to John F. (Jeff) Whorley, Jr., Executive Vice President of Sallie Mae in charge of its  
13 entire DMO business segment. Whorley is based in Fishers. Whorley's chief assistants in the  
14 SAC division were Charles Dotson and Michelle Beckley.

16           **B. USAF's Business Operations**

17           86. USAF is a tax-exempt, non-profit corporation, operating the nation's largest  
18 student loan guaranty agency under the HEA. Despite its size and importance in the student loan  
19 industry, USAF maintains only a very small staff of employees because it contracts out the  
20 majority of its operational work to Sallie Mae subsidiaries. To understand the present-day close  
21 ties between USAF and Sallie Mae, it is necessary to understand the history of their relationship.

23           87. As noted in ¶ 33 above, beginning in 1997, Sallie Mae began the process of  
24 transforming itself from a GSE to a private sector corporation. As part of the privatization  
25 process, Congress permitted Sallie Mae to issue student loan asset-backed securities  
26 ("securitization") in order to fund its operations through non-GSE sources. Sallie Mae's first  
27 major purchase after securitizing its loans was the acquisition of the USA Group on July 31, 2000.  
28

1 At the time of this acquisition, the USA Group owned USAF (then, and now, the guarantor for  
2 Sallie Mae's student loans), SAC, and several other subsidiaries of the USA Group. While USAF  
3 was owned by the USA Group, USAF contracted out the majority of its guarantor activities to its  
4 sister USA Group companies, including SAC.  
5

6 88. When Sallie Mae purchased the USA Group in 2000, Sallie Mae acquired all of the  
7 USA Group companies with the *exception* of USAF, which became an independent nonprofit  
8 company. USAF could not be included in the transaction because of the conflict of interest that  
9 would have resulted if the nation's largest student loan holder (Sallie Mae) also owned the  
10 nonprofit corporation that guaranteed the majority of its loans (USAF).

11 89. After becoming an independent company, however, USAF continued its prior  
12 business practice of contracting out to SAC and other subsidiaries of the USA Group – now  
13 owned by Sallie Mae – the vast majority of its operational work. In fact, many of the exact same  
14 people that worked for USAF under contract when it was part of USA Group continued in that  
15 same capacity after Sallie Mae took over the USA Group.  
16

17 90. Of particular relevance to this Complaint is USAF's relationship with Sallie Mae's  
18 SAC. Prior to 2000, when USAF and SAC were sister companies, the two companies shared  
19 building space in the USA Group headquarters in Fishers, Indiana, and USAF paid SAC to  
20 perform all of USAF's default aversion work.  
21

22 91. When Sallie Mae acquired USA Group in 2000, even though USAF was spun off  
23 as an independent company, as a practical matter nothing changed in the relationship between  
24 USAF and SAC. USAF and SAC continued to share the office complex in Fishers, Indiana (now  
25 owned by Sallie Mae), and USAF continued to hire SAC to perform all of USAF's default  
26 aversion work. But continuing this same business model *after* Sallie Mae became the owner of  
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1 SAC meant that USAF was hiring Sallie Mae to perform the guarantor's default aversion work on  
2 loans held by Sallie Mae.

3 92. In 2002, the OIG of ED examined this relationship in an Audit Report, and  
4 concluded that it was an "inherent conflict of interest" for USAF to hire SAC, a division of Sallie  
5 Mae, to perform USAF's default aversion work. See "United Student Aid Funds, Inc.'s  
6 Administration of the Federal Family Education Loan Program Federal and Operating Funds,"  
7 Final Audit Report, ED-OIG/A05-B0033 (April 2002), at pp. 1 and 5-6. The Report concluded:  
8

9 There is an inherent conflict of interest when [the same] entity performs default  
10 aversion and . . . holds/services . . . the same loans. As a result, the potential to  
11 manipulate default aversion . . . activities is greater than it would be if a separate  
entity performed default aversion activities.

12 *Id.* at 1. Consistent with this conclusion, OIG recommended that USAF be ordered to cure this  
13 inherent conflict of interest. *Id.* at 1 and 6.

14 93. Following publication of the Audit Report in April 2002, nothing was done to  
15 implement the recommendation of the OIG.

16 94. In November 2002, in a decision unrelated to the Audit Report, ED changed its  
17 policy on FFELP loan forbearances and began allowing lenders to grant verbal forbearances.  
18 Following that decision, Sallie Mae's Lending Division permitted SAC to grant verbal  
19 forbearances on behalf of the Lending Division. As noted above, this was a highly unorthodox  
20 delegation of authority, since SAC is strictly a guarantor servicing unit and performs no other  
21 work on behalf of lenders. (Sallie Mae is the only lender that allowed SAC to grant forbearances;  
22 every other lender required SAC to refer a request for forbearance directly to the lender.)  
23

24 95. The end result was that SAC had complete control over forbearances – granting  
25 them on behalf of Sallie Mae, and monitoring them on behalf of USAF. This blatant conflict of  
26 interest goes a long way in explaining how SAC could get away with the fraudulent forbearance  
27 mill for as long as it did.  
28

1 **VII. THE FABRICATION OF VERBAL FORBEARANCES AT SAC**

2 **A. Defendants Implemented Policies And Procedures That Pressured SAC**  
3 **Employees To Fabricate Forbearances**

4 96. When Relator began working for SAC in 2004, he discovered that call associates at  
5 SAC were routinely fabricating verbal forbearances on the delinquent accounts that they handled.  
6 This fraudulent practice was largely the consequence of policies and procedures put in place by  
7 SAC management, and condoned by Sallie Mae (SAC's parent) and USAF (SAC's largest client).  
8 These policies and procedures included: (i) a quota system that put tremendous pressure on  
9 employees to prevent loans from going into default in order to save their jobs; (ii) a bonus system  
10 that put group pressure on each individual to achieve the quota and that encouraged a code of  
11 silence about fraudulent conduct, and (iii) a deliberate absence of meaningful supervision or  
12 monitoring of the granting of verbal forbearances by the call associates that allowed them to  
13 fabricate these forbearances with impunity.  
14

15 97. SAC utilizes a quota system that requires each call associate to bring current a  
16 specified dollar value of delinquent loans each month. SAC sets the quotas at levels necessary to  
17 maintain a low default rate on loans held by Sallie Mae and guaranteed by USAF. Defendants  
18 have a financial incentive to keep these rates low. See ¶¶ 30, 170. Also, executives benefit  
19 personally by receiving large bonuses tied to bringing down the default rate.  
20

21 98. SAC establishes its quotas based upon the "team" to which the associate is  
22 assigned. Each team typically consists of 10 to 15 call associates. The teams are assigned to work  
23 on specific types of delinquent loans. For example, one team may be assigned to work on  
24 recently-delinquent loans (i.e., between 60 and 120 days delinquent); another team assigned to  
25 loans close to the default deadline of 270 days delinquent; another team assigned to high value  
26 loans, etc.  
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1           99. In Relator’s experience, the quota was always set at a level that was very difficult  
2 for even the most experienced and diligent call associates to reach. On teams to which Relator  
3 was assigned, the monthly quota for each team member was typically in the range of \$1.5 to 2  
4 million in delinquent loans that had to be brought current each month.

5           100. SAC enforced the quota by imposing a strict “three strikes and you’re out” policy.  
6 A call associate that did not meet the quota in one month received a preliminary disciplinary  
7 action (“PDA”) letter in the associate’s file. After receiving three PDA’s, the associate was fired,  
8 regardless of whether the associate’s conduct had been exemplary in all other respects.

9           101. Even if a call associate exceeded the quota by a substantial margin one month and  
10 barely missed reaching quota the next month, that did not matter—any month under quota was one  
11 strike and provoked a PDA letter in the associate’s file. This policy placed tremendous pressure  
12 on employees to meet the quota in order to hold onto their jobs.

13           102. SAC reinforced this pressure through its bonus system. SAC paid call associates a  
14 modest hourly wage – typically in the \$10 to \$15 per hour range – and in addition offered bonuses  
15 for achieving the monthly quota. The bonus would typically be between 20 and 25% of the call  
16 associate’s monthly salary. During most of the time period covered by this Complaint, *every*  
17 member of the call associate’s team had to achieve the quota in order for any team member to  
18 receive the bonus. In other words, if 14 members of a 15-person team met the quota, but one team  
19 member did not, the entire team lost its bonus. When a team lost its bonus, this also reduced the  
20 bonus of the Team Leader, the Floor Manager, and every above them in the corporate hierarchy.  
21 See ¶ 105 below.

22           103. Even if certain team members exceeded their quota in excess of the amount that  
23 others under-performed, the team still lost its bonus. There were also periods when the bonus was  
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1 computed on a quarterly basis, and if a call associate missed the quota in one of those three  
2 months, the entire team lost three months of bonus.

3           104. In this environment, if one or two team members were at risk of not meeting the  
4 quota in a given time period and letting the entire team down, the group pressure on them to do  
5 anything possible to reach the quota was extremely intense. Moreover, there was no incentive for  
6 any team member to report cheating by another team member, since the success of the team rested  
7 upon every team member reaching the quota. In the Spring of 2005, SAC finally ended the  
8 practice of awarding individual bonuses based upon the performance of every member of the  
9 team. For several years before it ended, however, this policy pressured SAC call associates to do  
10 whatever they could to meet their quota and earn a bonus for themselves and their teammates.

11           105. The bonus system had another ingenious way of encouraging a code of silence.  
12 Everyone up the corporate ladder shared in the bonus of those below. For example, the bonus of  
13 the SAC Supervisors, also called Team Leaders, was based upon a percentage of the bonus  
14 received by the call associates in the teams under them. The Floor Managers above the Team  
15 Leaders received a percentage of the Team Leaders' bonuses, and a percentage of the call  
16 associates' bonuses. This continued up the corporate ladder to the top managers. Thus, everyone  
17 in the hierarchy benefited financially when the call associates met their quota. In this setting, there  
18 was strong incentive to look the other way if call associates were meeting their quotas through  
19 fraudulent conduct.

20           106. SAC call associates were also eligible for another type of bonus. All Sallie Mae  
21 employees of whatever rank are given 500 shares of company stock (valued at \$26,000 at current  
22 prices) once a year, usually in October. The stocks vest, i.e., become redeemable, one year after  
23 the grant date (this was changed to 18 months in 2005) provided the employee is still working for  
24 Sallie Mae at that time. Because of the three-strikes policy, however, it was difficult for call  
25  
26  
27  
28

1 associates to hold onto their job until the shares vested – the average length of employment of a  
2 call associate was less than six months.

3 107. Those call associates who succeeded in holding onto their job for several months  
4 desperately wanted to hold onto their job through a year of employment, so that they would  
5 receive the 500 shares. Yet the majority of these associates, like the majority of all call associates,  
6 were typically close to the edge of being fired, having already received one or two PDA's. Having  
7 the 500 shares dangling in front of them only a month or two away, yet knowing that a single  
8 additional month of failure to achieve the quota would mean losing their job, created another  
9 source of tremendous pressure and incentive to do anything necessary to achieve the quota.  
10

11 108. In addition to structuring the disciplinary and bonus system to exert maximum  
12 pressure on the call associates to meet the quota, SAC also offered a series of "contests" with  
13 valuable prizes – such as gift cards (sometimes as high as \$2,500.00), entertainment systems, free  
14 trips, etc. – for meeting specific performance goals. These performance goals were typically  
15 related to bringing down the default rate on Sallie Mae loans guaranteed by USAF. Relator  
16 estimates that during the time period covered by this Complaint, SAC awarded hundreds of  
17 thousands of dollars in incentives and prizes to SAC call associates and supervisors for meeting  
18 short-term goals.  
19

20  
21 **B. How Call Associates Fabricated Verbal Forbearances**

22 109. All loans that Sallie Mae holds, whether Sallie Mae originated the loan or acquired  
23 it on the secondary market, are entered into Sallie Mae's computer system called the CLASS  
24 system.

25 110. On a daily basis Sallie Mae's Lending Division notifies USAF of the loans in  
26 CLASS that are guaranteed by USAF and that have become 60 days delinquent. The Lending  
27 Division requests the guarantor's default aversion assistance with regard to these loans. Because  
28

1 USAF hires SAC to provide these services, USAF sends to SAC headquarters in Fishers, Indiana  
2 the delinquent loan information that USAF receives from Sallie Mae, as well as from USAF's  
3 other lender-clients. SAC loads this information into a computer software program called the  
4 Borrow Pursuit System (BPS).

5  
6 111. SAC headquarters uses BPS to manage the daily work of the call associates at  
7 SAC's call centers in Fishers and in Las Vegas. SAC headquarters selects the loans that are to be  
8 worked each day by each team. SAC selects the loans based on a variety of criteria, such as the  
9 number of days delinquent or the dollar amount of the loan. The daily workload delivered by  
10 SAC into BPS is called the daily "campaign." A "campaign" can also extend beyond a single day.

11  
12 112. BPS uses the Avaya Predictive Dialing System, which is an automated dialing  
13 system. When a call associate finishes a call, the Avaya system automatically dials the next phone  
14 number on the list until someone answers the phone on the receiving end of the call. When the  
15 call is answered, the associate is connected to the call, and the associate's computer automatically  
16 displays the borrower's loan history from the CLASS system.

17  
18 113. The objective of the call associate on every call is to receive a "promise" from the  
19 borrower. A "promise" is any action or agreement by the borrower that, if kept, will bring a loan  
20 out of delinquency. For purposes of the monthly quota, a call associate is credited with the entire  
21 value of the outstanding principal and interest on a delinquent loan whenever the associate records  
22 in the BPS system a "promise" from the borrower.

23  
24 114. Once a call associate records a promise in the BPS system, the loan is temporarily  
25 taken out of delinquency status. The loan is placed in a holding status for two to 14 days to give  
26 time for the promise to be kept. If the promise is not kept, the loan is delivered back into BPS in  
27 14 days, and the amount of the loan that was previously credited to the call associate who scored  
28 the promise is deducted from that associate's tally of promises kept.

1           115. By far the easiest way to record a “promise kept” is through a verbal forbearance,  
2 since it does not require any follow-up action by the borrower. A verbal forbearance is considered  
3 a promise kept as soon as the call associate enters a notation into the computer system, and sends a  
4 confirming email to SAC headquarters, stating that the borrower was contacted and verbally  
5 agreed to the terms of the forbearance. Other methods to bring a loan current require some type of  
6 action by the borrower, such as payment of money, or signing and returning a written agreement.  
7 Although Sallie Mae sends a confirming letter to the borrower within 30 days of granting a verbal  
8 forbearance (as required by federal regulations), even if the letter is returned as undelivered, the  
9 verbal forbearance is still considered a promise kept and remains in effect.  
10

11           116. When a verbal forbearance is recorded in the CLASS system, the delinquent loan is  
12 taken out of delinquency status, and the call associate is given credit for the full amount of the  
13 borrower’s loan. For example, if the principal and accrued interest total \$40,000, the associate  
14 receives credit for \$40,000 in cured accounts toward the monthly quota.  
15

16           117. By far the most common circumstance where call associates fabricated verbal  
17 forbearances involved chronically delinquent accounts. Many borrowers use forbearance only  
18 once or twice and get back on the track of repayment. Chronically delinquent borrowers, in  
19 contrast, have typically received several years of deferments followed by several years of  
20 forbearance (often up to the maximum five years of forbearance allowed by Sallie Mae), with no  
21 indication of any intention to repay the loan. If these were Private Credit loans, Sallie Mae would  
22 have forced the loan into default long ago; but because FFELP loans are essentially risk-free,  
23 Sallie Mae keeps extending the loan knowing that the government is ultimately responsible for  
24 paying the loan balance when the borrower defaults.  
25

26           118. These chronically delinquent loans are typically very old, and the borrower contact  
27 information outdated, which makes it very difficult to reach these borrowers on the phone. The  
28

1 pattern and practice of many call associates working on these loans was to fabricate a verbal  
2 forbearance if the borrower could not be reached on the phone. By examining the loan history in  
3 the CLASS system, the call associate could see all previous grants of forbearance. Sallie Mae  
4 typically grants forbearances for one year at a time, up to a maximum of five years. If the loan  
5 history showed that the borrower had not already received the maximum of five years of  
6 forbearance, the call associate recognized that the borrower was a candidate for a verbal  
7 forbearance.  
8

9 119. The simplest way to fabricate a verbal forbearance was to remain on a call that was  
10 never answered to make it appear as if the associate were live on the line with the borrower.  
11 According to audit criteria formulated by SAC, the minimum amount of time necessary to process  
12 a verbal forbearance is two minutes; therefore, the call associate would stay on the silent line for at  
13 least two minutes. In this way, the associate was confident that the fabrication would not be  
14 discovered in the rare event that a post-call audit was conducted.  
15

16 120. Another way to fabricate a verbal forbearance was to speak with anyone who  
17 answered the phone, such as a spouse, family member, or roommate – none of whom have  
18 authority under the law to accept the terms of the forbearance – and enter into BPS that the  
19 borrower was contacted and agreed to the forbearance.  
20

21 121. During the time period covered by this Complaint, SAC had no system in place to  
22 prevent or detect fabricated verbal forbearances, even though such a system would have been very  
23 easy to implement. All that is necessary is a policy that requires the call associate to raise his or  
24 her hand when a borrower on the phone wants to agree to a verbal forbearance. The supervisor on  
25 the floor of the call center can then pick up an extension and listen in on the call to verify that the  
26 borrower is on the line and is agreeable to the terms of the forbearance.  
27  
28

1           122. In fact, this is precisely the system that SAC put into place on or about June 28,  
2 2005 after Relator repeatedly complained about the practice of fabricating verbal forbearances,  
3 and SAC management realized that it could no longer continue to ignore the practice. Once SAC  
4 instituted this system of supervisor verification, the SAC forbearance mill was effectively shut  
5 down. But for three years, between November 2002 and June 28, 2005, Relator is informed and  
6 believes that not a single verbal forbearance by a SAC call associate was verified. This is in stark  
7 contrast to the practice of Sallie Mae's DMO companies that handle Private Credit Loans, such as  
8 PRC and GRC. These companies follow a longstanding policy requiring supervisor verification of  
9 every verbal forbearance.  
10

11           123. The system of "random monitoring" of calls at SAC was also a sham. The Las  
12 Vegas call center had one Quality Assurance employee and three DMO compliance employees,  
13 who were responsible for monitoring the calls of more than 450 call associates (consisting of call  
14 associates at SAC, GRC, and PRC – the three Sallie Mae companies that share the Las Vegas call  
15 center). The monitoring system was a sham because every call associate knew when his or her call  
16 was being monitored, since there was a distinct echo and feedback on the call when monitoring  
17 was taking place.  
18

19           124. This problem could easily have been corrected with improved technology, but SAC  
20 preferred the status quo, which allowed call associates to be tipped off whenever their calls were  
21 being monitored. Furthermore, on the rare occasion that clients or government officials came into  
22 the SAC call centers to perform a random audit of the calling activity, the SAC supervisors would  
23 alert the call associates in advance so that they could be on their best behavior.  
24

25           125. The fact that many call associates were routinely fabricating verbal forbearances  
26 was known, or at best deliberately ignored, by SAC management. Evidence of the practice was  
27 apparent to anyone who cared to look for it. For example, all SAC call associates are provided  
28

1 activity reports on a daily basis showing, among other information, the quantity and value of loans  
2 each associate brought current during the time period of the report. These reports showed that  
3 some of the top-performing call associates were curing loans at rates virtually impossible to  
4 achieve.

5  
6 126. One example is the reported activity of call associate E.B. on Saturday, May 28th,  
7 2005.<sup>3</sup> E.B. was notorious for achieving results so far above average as to strain credulity.  
8 Saturday is a half-day, four-hour work day. Call associates are paid overtime if they work on  
9 Saturday, and the loans they are given to work on are the oldest and most difficult ones, typically  
10 involving borrowers that call associates have unsuccessfully attempted to contact on numerous  
11 previous occasions.

12  
13 127. In Relator's experience, on a typical Saturday, a call associate would be lucky to  
14 reach more than 1 borrower per hour. On that Saturday, E.B. reported *32 promises kept in four*  
15 *hours* on a Saturday morning. Everyone knew that E.B. could achieve these numbers only by  
16 falsifying the call records to make it appear that the borrowers had been contacted and agreed to a  
17 verbal forbearance.

18  
19 128. When Relator examined the records of some of the borrowers that supposedly  
20 agreed to verbal forbearances on E.B.'s calls, Relator saw that E.B. provided no information  
21 whatsoever concerning the borrower contact – no updated contact information, nor any  
22 information concerning the circumstances of the borrower justifying a forbearance. This was the  
23 typical pattern of the fabricators – just a simple notation that the borrower agreed to a verbal  
24 forbearance, with no additional information.

25  
26 129. SAC policy required call associates to note in the BPS system any pertinent  
27 information concerning the borrower learned during the contact; however, the company never

28  

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<sup>3</sup> The full name of call associates referred to herein by initials will be provided as necessary.

1 enforced this requirement. Relator saw many chronically delinquent loans in the CLASS system  
2 where verbal forbearances were granted without a single piece of new information entered into the  
3 system, other than the simple notation, "Forbearance granted by SAC contact, expires...." One  
4 would expect that addresses and phone numbers would be updated on the dates the forbearance  
5 activity occurred, or some indication of the circumstances justifying a forbearance grant. But the  
6 correspondence histories of these loans were remarkably absent any new or updated information at  
7 all.

9 130. Some call associates, like E.B. and others, abused the practice of fabricating verbal  
10 forbearances worse than others. The very smartest of the cheaters knew not to over-do their own  
11 performances, which would call attention to themselves. Since the bonus did not graduate upward  
12 and was always a fixed amount, there was no incentive to overachieve. But some of the associates  
13 could not resist the temptation to outperform their colleagues. This was also encouraged by SAC  
14 management, which offered "contests" where the highest achievers won valuable prizes. See ¶  
15 108 above. The highest-performing call associates reported truly unbelievable cure numbers –  
16 without updating any borrower contact information in their call notes.

18 131. For even the best call associates (the honest ones, that is), the average cure rate was  
19 in the range of \$10,000 to \$15,000 per hour worked. Yet the activity reports showed that some  
20 associates were scoring an astonishing \$85,000 in loans brought current per hour, *every hour they*  
21 *worked*, in a given month! Everyone knew this was impossible, but management chose to look the  
22 other way. Nothing was said or done about it because all bonuses, all the way up the corporate  
23 ladder, were predicated on these numbers.

25 132. Evidence of the fabricated verbal forbearances can also be seen in the default rates  
26 reported by Sallie Mae before and after verbal forbearances were allowed in 2002. In a  
27 submission to the Securities and Exchange Commission on July 12, 2004, Sallie Mae reported the  
28

1 “cumulative default rate” on its loans for the period 1995 through 2003. Although the submission  
2 does not define precisely how this rate was calculated, it shows a dramatic decline in Sallie Mae’s  
3 default rate immediately after verbal forbearances were allowed. According to the submission,  
4 Sallie Mae’s loan default rate went from a high of 7.22% in 2000 to a low of 0.10% by the end of  
5 2003 (the first full year after verbal forbearances were allowed). A default rate of .10% indicates  
6 almost no defaults in Sallie Mae’s loans. This would be consistent with the observation of Relator  
7 that SAC associates were using fabricated verbal forbearances to cure virtually every past-due  
8 loan that could not be cured in a legitimate manner.  
9

10 133. An independent guarantor monitoring the forbearance practices of Sallie Mae  
11 would never have allowed this forbearance mill. But USAF abdicated its statutory role of  
12 independent oversight of Sallie Mae by hiring SAC to act on USAF’s behalf, which meant that  
13 SAC was placed in charge of granting forbearances (on behalf of Sallie Mae’s Lending Division)  
14 and policing the granting of forbearances (on behalf of USAF) all at the same time. This conflict  
15 of interest allowed SAC to get away with the forbearance mill for as long as it did.  
16

17 134. Relator is informed and believes that between November 2002 and June 28, 2005,  
18 USAF never questioned a single verbal forbearance grant by SAC, never required any verification  
19 of verbal forbearances, and never denied a guarantee payment based upon SAC’s forbearance  
20 practices. Nothing within USAF’s systems prevented the constant extension of these delinquent  
21 loans, most of which would have defaulted years ago, if not for the forbearance grants. With  
22 every grant of forbearance, the principal and interest grew on the delinquent loans, ultimately to be  
23 paid by the taxpayer.  
24

25 **C. SAC’s Policy Changes In June 2005 Demonstrate That The Problem of**  
26 **Fabricated Forbearances Was Real**

27 135. Although SAC call associates were routinely fabricating verbal forbearances, no  
28 one complained or tried to stop it. This was because everyone benefited from it, from top to

1 bottom. Relator broke the code of silence within the company in May 2005. Relator at first  
2 complained about the practice to his immediate supervisor, and when the supervisor did not  
3 address his concerns, Relator brought the matter to the attention of SAC's Corporate Compliance  
4 Officer.

5  
6 136. Relator's initial complaint to his supervisor and then to Corporate Compliance was  
7 prompted by the fact that Relator, who did not participate in the practice of fabricating  
8 forbearances, had received a PDA in April for not meeting his monthly quota. Relator complained  
9 about the unfairness of a policy that disciplined employees for handling accounts honestly and  
10 conscientiously, and awarded bonuses and prizes to employees that were engaging in fraudulent  
11 conduct.

12  
13 137. SAC management at first ignored and then tried to silence Relator's complaints in  
14 various ways. These actions included, variously, instructing him to not concern himself with  
15 matters outside of his own specific job function, disciplining him, suspending him, and harassing  
16 him. See ¶¶ 163-68. When that that did not succeed in silencing Relator, management shifted its  
17 strategy and began to embark on a strategy to create deniability should the fraudulent forbearance  
18 practices be publicly exposed.

19  
20 138. The first step management took to create deniability was to distribute to all SAC  
21 employees a memorandum written by Jeff Schnell, director of SAC Las Vegas, on June 21, 2005.  
22 In the memorandum, Schnell warned employees that it was strictly against company policy to  
23 falsify information in BPS concerning a borrower contact. The memorandum also instructed call  
24 associates to "document your accounts thoroughly and accurately, so when somebody reviews the  
25 account there is no doubt as to what took place." The only problem with this memorandum, that  
26 said all the right things, was that it came three years too late. For three years, the company had  
27  
28

1 looked the other way as call associates routinely granted verbal forbearances without providing  
2 *any* details of the supposed contact with the borrower.

3 139. One week later, on June 28, 2005, SAC changed its policy on verbal forbearances  
4 and required a supervisor to come on the call and verify the verbal forbearance. This change was  
5 an implicit admission that the problem Relator had identified – widespread fabrication of verbal  
6 forbearances – was real.

8 140. After this change in policy, the number of loans brought current by call associates  
9 fell dramatically, providing further evidence of the problem Relator had identified. For example,  
10 the overall Activity Report for a two-week period in May 2005 (*i.e.*, shortly before the change in  
11 policy) showed a total of 18,676 promises kept, for a total of \$241 million in cured loans; a  
12 comparable period in July (shortly after the policy change) showed only 8,483 promises kept, for a  
13 total of \$117 million in satisfied loan – a dramatic decline that is largely attributable to requiring  
14 verification of verbal forbearances.

16 141. The cure numbers reported by call associates who were notorious abusers of the  
17 verbal forbearance system show the most dramatic decline after the new policy went into effect.  
18 For example, one such call associate reported \$2,590,000 in cured loans in the two week period in  
19 May, and this fell over 80% to \$419,946 in the comparable period in July after supervisor  
20 verification was in place. There are many other similar examples in the SAC activity reports.

22 142. Default rates for 2005 have not yet been published, but based on the above, Relator  
23 is informed and believes that the default rates reported by Sallie Mae and USAF in 2005 will  
24 increase significantly over the 2004 rates, due largely to the elimination of fabricated verbal  
25 forbearances after June 28, 2005, as well as the fact that many borrowers have by now exhausted  
26 their maximum five years of forbearance and no other options remain.

27 **D. Defendants Defraud The Federal Treasury Through A Number Of Other**  
28 **Improper Practices**

1  
2 143. In addition to the practices described above, defendants engage in a number of  
3 other practices that defraud the federal treasury. These practices include but are not limited to the  
4 following:

5 **1. Violation of Due Diligence Requirements For Loan Originations**

6 144. The HEA requires a FFELP lender to exercise due diligence in originating loans to  
7 ensure that the lender has a reasonable basis to believe that the borrower will be able to repay the  
8 loan and that the lender has accurate identifying information for the borrower in order to locate the  
9 borrower to enforce repayment. Based on his experience working on delinquent loan accounts at  
10 SAC, Relator is informed and believes that Sallie Mae failed to exercise minimal due diligence on  
11 large numbers of FFELP loans that it originated.

13 145. The safeguard provided by the HEA against negligent loan originations is oversight  
14 of the lender by an independent guarantor; and forfeiture of the guarantee payment if the guarantor  
15 finds that the lender did not exercise due diligence in the loan origination. However, as alleged  
16 above, USAF does not exercise independent oversight of Sallie Mae's lending practices. Relator  
17 is informed and believes that USAF never denies a guarantee payment for negligence in the loan  
18 origination. The net result is that, from Sallie Mae's point of view, FFELP loans are risk-free  
19 lending.  
20

21 146. On its Private Credit loans, for which Sallie Mae bears the credit risk, Sallie Mae is  
22 extremely diligent in its loan originations. On these loans, in addition to verifying all borrower  
23 identifying information, Sallie Mae typically requires co-signers, co-borrowers, endorsers,  
24 references, and employer contact information. Sallie Mae did not exercise this degree of diligence  
25 on its federally guaranteed loans. Relator worked on many FFELP loans with obviously  
26 incomplete or inaccurate borrower contact information, including loans issued to borrowers who  
27 were deceased at the time the loan was disbursed, borrowers with bogus contact information,  
28

1 borrowers whose social security numbers did not match the borrower information, and other  
2 problems that would have been discovered with minimal due diligence. When these loans default,  
3 the taxpayer foots the bill.

4 **2. Pattern And Practice Of Improper Conduct Involving Consolidation Loans**

5 147. Sallie Mae engaged in a number of improper practices involving consolidation  
6 loans.

7  
8 148. First, Relator saw many accounts in the CLASS system in which Sallie Mae had  
9 provided a consolidation loan to a delinquent FFELP borrower in circumstances where there was  
10 no realistic prospect that the borrower would repay the loan. Many of these borrower had already  
11 used up the maximum number of deferments and five full years of forbearance, without a single  
12 payment being made or any indication of borrower intent to repay the loan. This is a violation of  
13 the lender's due diligence obligation on loan originations. A prudent lender would not provide a  
14 loan in these circumstances; yet Sallie Mae did so, knowing that its guarantor, USAF, would never  
15 reject the guarantee payment for violation of the lender's due diligence obligations, no matter how  
16 irresponsible the lending decision.

17  
18 149. Second, Sallie Mae gained consolidation loan business by misappropriating  
19 confidential information belonging to USAF. Sallie Mae designed, built and maintains the USAF  
20 website under a fee-for-service agreement. Sallie Mae included in the site design the ability to  
21 link to Sallie Mae's computer system any borrower consolidation request sent to USAF, even if the  
22 borrower's primary lender is a company other than Sallie Mae. The only requirement to gain this  
23 link is that the borrower have at least one dollar in Sallie Mae loans, and an aggregate loan amount  
24 of \$5,000. If the borrower has multiple loans from multiple lenders, and one of those loans is a  
25 Sallie Mae loan, the borrower is directly linked to the Sallie Mae website to the exclusion of  
26 USAF's other lender-clients. In 2005, Sallie Mae boasted publicly to analysts and investors that it  
27  
28

1 had secured more than two billion dollars worth of federal consolidation loan business from its  
2 competitors. The above scheme explains how it did so.

3 150. Third, Sallie Mae gained consolidation business by taking improper advantage of  
4 USAF's relationship with SAC, which performs USAF's default aversion work. Each SAC  
5 associate has a Sallie Mae email address that ends in "@salliemae.com." Even though SAC works  
6 exclusively on behalf of guarantors, and therefore should be lender-neutral, Sallie Mae  
7 deliberately did not create a sub-group of email addresses for its SAC employees that removed the  
8 Sallie Mae brand name. Thus, when the SAC associate, performing default aversion services for  
9 USAF, sent an email to a borrower of another lender-client of USAF, such as Citibank or Wells  
10 Fargo Bank, the borrower saw a "@salliemae.com" email originator. This gave the borrowers the  
11 impression that their student loan was connected to Sallie Mae. This led many borrowers to  
12 contact Sallie Mae, which allowed Sallie Mae to steer these borrowers to Sallie Mae for  
13 consolidation loans.  
14  
15

16 151. On several occasions, Relator spoke to delinquent borrowers who stated that their  
17 delinquent loans had been consolidated without their knowledge or consent. Based on the pattern  
18 and practice of conduct described in this Complaint, Relator is informed and believes that some  
19 percentage of these consolidation loans may have been fabricated by Sallie Mae employees. One  
20 way in which consolidated loans can be fabricated is by falsifying borrower signatures through the  
21 on-line signature option of Sallie Mae systems.  
22

23 152. The federal government bears the risk of loss if the borrower defaults on these  
24 consolidation loans.

25 **3. Deliberate Delay In Billing Borrowers**  
26  
27  
28

1 153. As a matter of policy, Sallie Mae does not generate a paper mailed billing until 120  
2 days after a FFELP loan payment is due, unless the customer specifically requests a paper bill.  
3 Sallie Mae encourages its borrowers to use on-line payment methods instead.

4 154. Not sending a timely paper bill has the greatest impact on PLUS and Consolidation  
5 loans which go into repayment immediately. Many of these borrowers, unaware that payment has  
6 become due, do not make a timely payment, and the loan becomes delinquent. This generates fee  
7 income for Sallie Mae because USAF pays Sallie Mae's SAC a fee to provide default aversion  
8 services for loans over 60 days delinquent. These newly delinquent loans are relatively easy to  
9 bring current – generally through repayment or forbearance – which generates additional income  
10 in the form of accrued interest, as well as default aversion fees paid to USAF (and passed on to  
11 SAC) from the Federal Fund.  
12

13  
14 **4. Improper Crediting Of Payments**

15 155. During the period of a federal deferment or a forbearance, the borrower is relieved  
16 from payment obligations on the loan. If a borrower makes a payment during this period of time,  
17 the HEA requires the lender to credit the payment first against the interest that has accrued during  
18 the period of the deferment or forbearance, with the remainder credited to reduce the principal  
19 balance.

20 156. Based on his examination of delinquent accounts in the CLASS system, Relator is  
21 informed and believes that Sallie Mae does not credit the payments in the required manner. For  
22 example, if the borrower makes a payment equivalent to one month's installment, instead of  
23 crediting this against interest, Sallie Mae credits it as a regular monthly installment and extends  
24 the forbearance or deferment period forward by one month. This extends the interest that  
25 accumulates, which is capitalized during periods of forbearance. The net effect of this practice is  
26  
27  
28

1 to increase the borrower's indebtedness, which is ultimately paid by the government if the  
2 borrower defaults.

3 **5. Hiding Old Loans That Should Have Defaulted**

4 157. As noted above, a FFELP loan is eligible for default when it has been delinquent  
5 for 270 days. FFELP program regulations require the lender in most circumstances to file a  
6 default claim with the guaranty agency within 90 days after the loan is eligible for default. If the  
7 lender fails to comply with this requirement, the guarantee payment to the lender and the  
8 reinsurance payment to the guarantor may be forfeited.

9 158. While employed at SAC, Relator worked on many Sallie Mae loans guaranteed by  
10 USAF that were delinquent well beyond 360 days, without Sallie Mae filing a default claim with  
11 USAF. During most of the spring of 2005, for example, Relator was regularly working on  
12 accounts that were in excess of 500 days delinquent. These loans appear in the BPS system with  
13 no explanation for why they are there, and with no contact attempts made in months. Call  
14 associates refer to these accounts as having come into the system from "limbo" or "la-la land."  
15 The one common denominator in all of these very old loans is that they should have defaulted in  
16 the previous trigger year, and were somehow withheld and brought into the current trigger year.

17 159. One way to hide the irregularities in the handling of these loans is to bring the loan  
18 current – for example, through a forbearance or through a consolidation loan. Once the loan is  
19 brought current, the preceding period of delinquency is considered cured, and any irregularities in  
20 the handling of the loan are buried away deep in the history of the loan. Relator is informed and  
21 believes that USAF never refuses to honor a default claim because of irregularities in the history  
22 of the loan.

23 **6. Moving FFELP Loans to the Direct Loan Program**

1           160. Relator is informed and believes that one option Sallie Mae uses to prevent  
2 delinquent FFELP loans from going into default is to encourage the borrower to move their  
3 FFELP loans to the Direct Loan program. The Direct Loan program provides loans directly from  
4 ED. Relator is informed and believes that Sallie Mae tries to use this option when the borrower  
5 has used up the maximum periods of deferment and forbearance and has no other options  
6 available. These are loans that Sallie Mae has extended well beyond the point at which a prudent  
7 lender would do so, solely for the purpose of maximizing the borrower's indebtedness. To the  
8 extent Sallie Mae is successful in moving these loans to the Direct Loan program, the taxpayer  
9 foots the bill for Sallie Mae's improper conduct.

11           -       -       -       -       -       -       -       -       -       -       -       -

12  
13           161. The practices outlined above are meant to be illustrative and not exhaustive of the  
14 practices of defendants that defrauded the federal treasury. Based on the pattern and practice of  
15 fraudulent conduct identified in this Complaint, Relator is informed and believes that defendants  
16 engaged in numerous other fraudulent practices in addition to those discussed above. As these  
17 practices are further identified during discovery in this case, Relator will seek to amend this  
18 Complaint accordingly.

19           **VIII. SALLIE MAE DISCIPLINED AND ULTIMATELY DISCHARGED RELATOR IN**  
20           **RETALIATION FOR CONDUCT PROTECTED BY THE FCA**

21           162. Relator began working for SAC in November 2004. After only a few weeks of  
22 working there, he became aware of the fraudulent practices alleged in this Complaint. Relator first  
23 brought the practices to the attention of the Securities and Exchange Commission ("SEC") on or  
24 about March 15, 2005. One purpose for Relator's communications with the SEC was to inform  
25 the agency of Sallie Mae practices that affected the accuracy of representations made by Sallie  
26 Mae in public filings with the SEC. Thereafter, Relator had several follow-up communications  
27 with the SEC concerning the practices alleged herein.

1           163. In early May 2005, Relator was called into the office of his Supervisor to discuss  
2 the fact that Relator had received a PDA in April for not achieving his monthly quota. This was  
3 Relator's second PDA, having received one the month before for not achieving the March quota.  
4 Relator complained to his supervisor about the unfairness of a policy that disciplined him for  
5 handling accounts honestly and conscientiously, and awarded bonuses and prizes to employees  
6 that were lying and cheating to meet the quota. The supervisor did not address his complaints and  
7 warned Relator that he would be fired if he received another PDA.

9           164. Following that meeting, Relator wrote an email to SAC's Human Resources  
10 Department ("HR"), in which Relator complained about improper practices at SAC. HR  
11 forwarded the email to Corporate Compliance. Relator met with the Corporate Compliance  
12 Officer on May 16, 2005, and explained in detail many of the allegations in this Complaint.  
13 Among other information, Relator explained that certain employees were routinely fabricating  
14 verbal forbearances. As an example, Relator pointed to the cure numbers reported by one  
15 particular employee, F.B., who was abusing the practice worse than others.

17           165. Relator is informed and believes that someone in either HR or Corporate  
18 Compliance notified F.B. of the allegations, since on the very next day, F.B. filed with HR a  
19 sexual harassment complaint against Relator. The complaint was entirely baseless and never  
20 pursued. Nevertheless, when HR received the complaint, Relator was immediately suspended for  
21 three days with pay—to Relator's knowledge, it is unprecedented to suspend a call associate *with*  
22 *pay*. Relator interpreted the action as a warning that he risked greater retaliation if he continued to  
23 press his complaints about employees fabricating forbearances.

25           166. After Relator returned to work following his three-day suspension, Relator was  
26 subjected to various forms of harassment within the office. Relator, however, refused to be  
27 intimidated into silence. Relator continued to press his complaints, both with the Corporate  
28

1 Compliance Officer and with SAC management. The Compliance Officer and SAC management  
2 instructed Relator in various ways that he should not concern himself with matters outside of his  
3 own area of responsibility, but Relator pressed on with his complaints. When SAC realized that  
4 Relator would not be silenced, and that the practices might ultimately be exposed to the public,  
5 SAC shifted its strategy and ultimately introduced a system of supervisor verification of verbal  
6 forbearances. See ¶¶ 137-39 above.

8 167. By early July 2005, Relator had lost confidence in the integrity of SAC  
9 management. In early July 2005, Relator contacted the Government Accounting Office (“GAO”)  
10 and informed GAO of many of the allegations contained in this Complaint. In the ensuing weeks,  
11 Relator had several communications with the GAO, in which Relator responded to specific  
12 requests for information from the GAO.

14 168. SAC terminated Relator’s employment on August 16, 2005, immediately following  
15 SAC’s learning that Relator had provided information to the GAO. The specific reason given for  
16 the termination was that Relator had provided information to the GAO that Relator had transferred  
17 from Sallie Mae’s computer system to Relator’s personal email without authorization. Relator is  
18 informed and believes that this reason for termination was a pretext for the real reasons that SAC  
19 fired Relator, viz., to retaliate against him for shining light on the practices alleged herein, and to  
20 punish him for providing information concerning these practices to the Government.

22 **IX. DAMAGE TO THE TREASURY**

23 169. As noted in the Applicable Law section above, if a lender or a guaranty agency  
24 does not comply with all of its due diligence obligations under the HEA, the guarantee payment on  
25 a default to a lender or a reinsurance payment to a guarantor may be forfeited. See ¶ 72 above.  
26 The fraudulent practices alleged in this complaint constituted a serious breach of the due diligence  
27  
28

1 obligations of Sallie Mae and USAF and require forfeiture of every guarantee payment or  
2 reinsurance payment received by them on the affected loans.

3 170. In addition, the practice of fabricating verbal forbearances caused specific damage  
4 to the Treasury in at least the following regards:

5 a. Fabricated verbal forbearances extended loans that should have defaulted and  
6 increased the amount ultimately paid by the federal government upon later default of the loan.

7 b. Fabricated verbal forbearances increased the default aversion fees paid to USAF by  
8 ED by preventing loans that otherwise would have defaulted from immediately going into default.

9 c. Fabricated verbal forbearances allowed SAC to meet performance goals established  
10 by USAF that entitled SAC to receive a greater share of the default aversion fees paid by the  
11 federal government to USAF.

12 d. Fabricated verbal forbearances lowered the cumulative default rate on loans held by  
13 Sallie Mae and increased federal guarantee payments tied to the default rate.

14 e. Fabricated verbal forbearances lowered USAF's cohort trigger default rate and  
15 increased federal reinsurance payments tied to that default rate.

16  
17  
18 **COUNT I**  
19 **False Claims Act**  
20 **31 U.S.C. § 3729(a)(1)**

21 171. Relator realleges and incorporates by reference the allegations in paragraphs 1- 170  
22 of this Complaint.

23 172. This is a claim for treble damages and penalties under the False Claims Act, 31  
24 U.S.C. §§ 3729 *et seq.*, as amended.

25 173. Through the acts described above, defendants and their agents, employees and co-  
26 conspirators have knowingly presented or caused to be presented to the United States Government  
27 false or fraudulent claims for payment or approval.  
28

1 174. As a result of these false claims, the United States has been damaged and continues  
2 to be damaged, in an amount to be determined at trial.

3  
4 **COUNT II**  
5 **False Claims Act**  
6 **31 U.S.C. § 3729(a)(2)**

7 175. Relator realleges and incorporates by reference the allegations in paragraphs 1- 170  
8 of this Complaint.

9 176. This is a claim for treble damages and penalties under the False Claims Act, 31  
10 U.S.C. §§ 3729 *et seq.*, as amended.

11 177. Through the acts described above, defendants and their agents, employees and co-  
12 conspirators have knowingly made, used and caused to be made and used false records and  
13 statements to get false or fraudulent claims for services paid or approved by United States  
14 Government.

15 178. As a result of these false claims, the United States has been damaged and continues  
16 to be damaged, in an amount to be determined at trial.

17  
18 **COUNT III**  
19 **False Claims Act**  
20 **31 U.S.C. § 3729(a)(3)**

21 179. Relator realleges and incorporates by reference the allegations in paragraphs 1-170  
22 of this Complaint.

23 180. This is a claim for treble damages and penalties under the False Claims Act, 31  
24 U.S.C. §§ 3729 *et seq.*, as amended.

25 181. Through the acts described above, defendants Sallie Mae, USAF, SAC, and their  
26 agents and employees, conspired with each other and with others to defraud the United States by  
27 inducing the United States to pay or approve false or fraudulent claims. Defendants also took  
28

1 substantial steps in furtherance of the conspiracy, inter alia, by making fraudulent representations,  
2 by preparing fraudulent records and by failing to disclose material facts.

3 182. As a result of these false or fraudulent claims, the United States has been damaged  
4 and continues to be damaged in an amount to be determined at trial.

5  
6 **COUNT IV**  
7 **False Claims Act – Employment Discrimination**  
8 **31 U.S.C. § 3730(h)**

9 183. Relator realleges and incorporates by reference the allegations made in Paragraphs  
10 1 -170 of this Complaint.

11 184. This is a claim for damages under the Federal False Claims Act, 31 U.S.C.  
12 §3730(h).

13 185. Through the acts described above and otherwise, defendants discriminated against  
14 Relator in the terms and conditions of his employment at SAC by, among other things,  
15 disciplining, suspending, harassing, and ultimately firing him. Defendants took these actions in  
16 part to retaliate against Relator for shining light on the practices alleged herein, in part to silence  
17 him, and in part to punish him for providing information concerning the practices alleged herein to  
18 the Government.

19 186. Based on the forgoing, defendants discriminated against Relator in his employment  
20 at SAC because of lawful acts done by him in furtherance of actions protected by the False Claims  
21 Act, in violation of 31 U.S.C. § 3730(h).

22  
23 **PRAYER FOR RELIEF**

24 WHEREFORE, Relator prays for judgment against the defendants as follows:

- 25 1. that defendants cease and desist from violating 31 U.S.C. §3729 *et seq.*;
- 26 2. that this Court enter judgment against defendants in an amount equal to three  
27 times the amount of damages the United States has sustained because of defendants' actions,  
28

1 plus a civil penalty of not less than \$5,500 and not more than \$11,000 for each violation of 31  
2 U.S.C. §3729;

3 3. that Relator be awarded the maximum amount allowed pursuant to §3730(d) of the  
4 False Claims Act;

5 4. that Relator be awarded all costs of this action, including attorneys' fees and  
6 expenses;

7 5. that the Court enter judgment against defendants as a result of their actions in  
8 violation of 31 U.S.C. § 3730(h) as well as all relief necessary to make Relator whole, including  
9 reinstatement with the same seniority status Relator would have had but for the discrimination, not  
10 less than two times the amount of back pay, interest on back pay, and compensation for any  
11 special damages sustained as a result of defendants' employment discrimination, including  
12 litigation costs and reasonable attorneys' fees; and

13 6. that the United States and Relator be granted all such other relief as the Court  
14 deems just and proper.

15  
16  
17 **REQUEST FOR TRIAL BY JURY**

18 Pursuant to Rule 38 of the Federal Rules of Civil Procedure, Relator hereby demands a  
19 trial by jury.

20 Dated: November 8, 2005

Respectfully submitted,

PHILLIPS & COHEN LLP

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